UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK
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IN RE: AMERICAN EXPRESS ANTI-STEERING

RULES ANTITRUST LITIGATION (II) 11-MD-02221-NGG-RER

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THE MARCUS CORPORATION, on behalf of itself and all similarly situated persons,

Plaintiff, 13-CV-07355-NGG-RER

versus UNITED STATES DISTRICT COURT
BROOKLYN, NEW YORK

AMERICAN EXPRESS COMPANY, et al.,
Defendants.
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SEPTEMBER 17, 2014
10:00 A.M.

TRANSCRIPT OF FAIRNESS HEARING
BEFORE THE HONORABLE NICHOLAS G. GARAUFIS,
UNITED STATES DISTRICT COURT JUDGE

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Proceedings recorded by mechanical stenography, transcript produced by computer.

THE COURT: Please be seated.

THE CLERK: Civil cause for a fairness hearing. Lead counsel for the parties state your appearances.

MR. FRIEDMAN: Gary Friedman for the class plaintiffs. Good morning, your Honor.

THE COURT: Good morning.

MR. KOROLOGOUS: Good morning, your Honor. Philip Korologous for American Express.

THE COURT: Good morning. All right. And?

MR. CANTER: Your Honor, Michael Cantor for the objectors, Target and National Retail Federation.

THE COURT: All right. As we get to the objectors' portion of the fairness hearing, we'll have you state your appearance again for the court reporter.

All right. This is a fairness hearing regarding the class settlement agreement in In Re American Express Anti-Steering Rules Antitrust Litigation, 11-MD-2221 and Marcus Corporation versus American Express Company, 13-CV-7355.

We're going to proceed today in accordance with the order that I issued recently beginning with the proponents of the approval of the agreement. First class plaintiffs, Mr. Friedman will speak first and then I understand on behalf of AmEx, Mr. Korologous you're going to speak second.

MR. KOROLOGOUS: That's correct, your Honor.

THE COURT: And you're allotted 60 minutes and we have a timer. And you are, of course, permitted to use less time than you're allotted. But you are certainly permitted to use as much time as you're allotted.

Is there anything we need to do before we begin the presentations? Hearing nothing, let's start on behalf of the class plaintiffs. Mr. Friedman.

MR. FRIEDMAN: Good morning, your Honor.

THE COURT: Good morning.

MR. FRIEDMAN: Gary Friedman for the class plaintiffs.

Ten years ago, the Marcus Corporation filed suit against American Express. Marcus turned to the legal system and the antitrust laws to try to find some way to control their payment card acceptance costs because normal market forces were not working. If someone had told Marcus at that time that we would be standing here today one fairness hearing away from merchants in the United States having the right to impose surcharges on credit card transactions, not just on AmEx but also on Visa cards, on MasterCard cards, on Discover cards for the first time ever in US history, Marcus would have been thrilled.

Thrilled because the settlement agreement here today provides Marcus and 6 million other merchants with unprecedented opportunities to control those card acceptance

costs by recouping the fees that they paid to the credit card networks, by driving transaction volume to debit which is far cheaper, by driving transaction to cash also by driving transaction card volume to other credit card brands on which the consumer is not responsible for paying a surcharge. And I'll unpack all of that here in my remarks this morning.

Ten years ago, the idea of being able to surcharge credit cards in the United States seemed farfetched. In Australia, the experiment with credit card surcharging was in its earliest infancy. And all the merchants there, all the large merchants were saying they will never do it, it'll never take hold. The Australian Retail Federation in its submissions pre-reform to the Reserve Bank of Australia said that it is totally unrealistic to expect that merchants will take up surcharging in Australia, it won't happen, the quote, competitive forces amongst merchants with key surcharging could ever, catching on. And that sounds a lot like what we're going to hear here, from the objecting merchants, from some of the objecting merchants.

And here at home, the idea of surcharging just seemed like a pipe dream. You had the Visa no surcharge rule, the MasterCard no surcharge rule, Discover had a rule back then, and there's the AmEx rule. On top of that, there were ten state statutes, the enforceability of which no one ever doubted and which no one had any incentive to challenge,

whether in the courthouse or the state house, because of all those network rules.

So for a merchant in, say, New York state there were four -- all four network rules and state law, in essence five walls standing between that merchant and the ability to engage in surcharging.

THE COURT: Well, let me just ask you this: There are no surcharging statutes in a number of states. Correct?

MR. FRIEDMAN: Correct.

THE COURT: We can start with California. Right? Do they have a non-surcharging law?

MR. FRIEDMAN: They have a statute. It's been held by courts there to actually compel only disclosure of the surcharge but that's going to get sorted out because there is an ongoing litigation challenging it directly.

THE COURT: And then there's Texas.

MR. FRIEDMAN: Yes.

THE COURT: They have one. And Florida has one.

MR. FRIEDMAN: Yes.

THE COURT: And several other states have them.

MR. FRIEDMAN: Correct.

THE COURT: So as of this moment, there are impediments to permitting surcharging in those jurisdictions. Correct?

MR. FRIEDMAN: That's correct. That's exactly

right.

THE COURT: All right. And if approved, this settlement will be of varying consequence to residents in those states and others.

MR. FRIEDMAN: That is exactly right.

So for the majority of merchants, this is the last wall, what's on the table right here today. For some merchants in some states, it's the second to the last wall.

THE COURT: The last wall being statutory.

MR. FRIEDMAN: The last wall being statutory. And without this network rule being removed, there can be no statutory challenge. There's no incentive, nobody will do it. This makes that meaningful. It puts every merchant one step closer. For the vast majority, it gets them all the way home. For a handful, they have another mountain to climb. And those mountains are being climbed. As we've pointed out in our papers, there are constitutional challenges afoot in Texas, in Florida, in California.

THE COURT: But if you're a company with a national operation, take Home Depot or CVS or Rite Aid, they could impose surcharging certain places but not in other places if this settlement is approved. Right?

MR. FRIEDMAN: For the time being, they could surcharge only in some places but not in other places if the settlement is approved. I will point out, however, that if

the settlement weren't approved, then some of the objectors here, the individual merchant plaintiffs in particular, are keen on saying they want to hold out for differential surcharging, the same is true there.

THE COURT: We'll get to differential surcharging in a moment.

MR. FRIEDMAN: Okay.

THE COURT: Go ahead.

MR. FRIEDMAN: But, your Honor, you pretty much brought me to the point of that, which is that for the majority of US merchants this is it, this is the last obstacle on a very long road.

So what I want to cover is, is I want to talk about some of the elements of value that this settlement provides to US merchants. I want to talk about why it is that we are so sure that these tools are going to in fact be used in the marketplace. And then I will address the class certification issues. But I'm going to start by talking about what the settlement does, what it is, and I think it's useful to have that out on the table.

The core of the settlement agreement is that it allows for surcharges. And the surcharging has to be done on a parity basis, it can't exceed the surcharge amount on any other credit card brand. It can't exceed the cost of acceptance that the merchant has on American Express.

THE COURT: Why did you press for differential surcharging? What's the reason for parity surcharging in this case?

MR. FRIEDMAN: We certainly did press for differential surcharging, and this reflects a compromise. And what I want to explain here this morning is just how much value there is in parity surcharging. Would differential surcharging have been better? I think we've said throughout our papers that it would have been.

I can't imagine a world where American Express willingly agrees to allow its cards to be differentially surcharged freely across the United States. I don't think that that is a viable litigation outcome on any model. We've looked very carefully at everything every objector has had to say.

I don't want to be cute here, but I think we used the term in one of our briefs, it's a litigation mirage, you can't get there from here. We tried to get there from here. We tried. We went through quite -- but -- now, I should dial that back. There is -- if the -- we could still make a run at differential surcharging. There is one way that you can get through the court system differential surcharging for all merchants in America. There's one way. I'll sketch it out right now, though it had been at the back app with my presentation.

If the settlement is rejected then, then the next up is the -- then there's the motion to dismiss our equitable claims, the class equitable claims in favor of arbitration.

We have strong arguments based on the vindication of rights doctrine from the Supreme Court. The Supreme Court reaffirmed the vindication of rights doctrine, it did not disavow it in Italian colors. And that's the portal that we want to -- I think that's very clear, Justice Scalia made statements reaffirming that there's a vindication of rights doctrine. I think this is a situation in which it applies.

Obviously, the objectors here disagree with that. Though nobody has spent any time in their submissions taking on this vindication of rights issue. But the only thing that is certain is that there will be appeals. However your Honor rules, it's appealable. Well, yes, but it's appealable in either direction and it is every bit the big heavy appellate case the Italian colors was, and I think frankly more so.

And I think that the -- so it's a very difficult road ahead. I think that there's a substantial likelihood of certiorari being granted. Who knows where it leads. The problem is if we go that road and we lose, then for 6 million merchants there's no ability to surcharge, none. So it's very risky. It would be a very risky gamble to just go into that -- to embark on that appellate journey understanding that if we're unsuccessful, that's it for 6 million merchants.

Now, what's really important, what I really want to convey to your Honor is just how much potential there is in the parity surcharge and relief to give relief to merchants, to do all the things that we set out to do when we brought the case from Marcus Corporation over a decade ago and to incite competition inside the credit card network. This is a compromise. And I want to focus on the value of what it is that we compromised for.

THE COURT: Do you have any indication on the ease with which it will be possible to engage parity surcharging for the restaurateur down the block here if this settlement is approved? I mean, some of what I've read is to the effect that it's difficult to explain, it's difficult to sell, and it's difficult to do.

MR. FRIEDMAN: It is easier to explain the parity surcharge. It's easier to do a parity surcharge than any other form of surcharge. This is the simplest surcharge. This is credit cards, 2 percent, debit free, we're done, as opposed to some schedule of rates. So it's easier than differential. But there's another aspect. I think --

THE COURT: But the parity surcharge would be by type of merchant? It would be different for different classes of merchants? For instance, airlines or retail drug chains or major big box retailors, there would be different parity surcharges for different classes of merchants?

MR. FRIEDMAN: We cannot possibly know. And let me put some flesh on the bones of that answer.

You'd think listening to the objectors, for example, that parity surcharging cannot possibly take hold in the places -- the places where it's most difficult to take hold, where there's a real impediment, are places where credit and debit are least substitutable. So that would be, say, high ticket merchants or merchants that have other drabs on substitutability between credit and debit, like hotels.

But here's what we know. In Australia all of the hotels, virtually all of the hotels are parity surcharging. That's a real life experiment, that's real world evidence, and we see that there. And if you're going to adopt -- if you're going to have the intuition or the theory that customer defection risks doom parity surcharging, you have to account for that real world evidence. Because if they're going to doom it anywhere, it's in high ticket. But they don't.

The other -- I mean, the hotels -- the other point, as long as we're on it, I'll stay on this point and Scott, can we go to the hotel slide because I think it's illustrative, another argument that we've heard from the objectors is, oh, well, where you're not going to see parity surcharging is in markets where it's competitive and the 7-Eleven objector's expert Professor Hausman said well, we think Australia is less competitive than the United States, and in competitive sectors

you're not going to see parity surcharging breaking out. But there's not a lot more competitive sectors than this.

Within a stone's throw of the Sydney Opera House, literally within a half a mile, every single one of these brands, every brand you see coming on here is parity surcharging. By the way, there are also a couple of other hotels in the area that choose not to surcharge. That's fine. The Intercontinental doesn't surcharge. Great. All of these brands do. Clearly, this is a competitive market. Clearly it is. It's just common sense.

Actually, if you can hit the next slide. Car rentals at the Sydney airport, I mean, talk about a competitive market, this is just as naked it as it gets. It's right out there for the world to see. There's the cars, there's the rates. And half of these brands are parity surcharging.

And parity surcharging is nearly universal in huge slots of commerce in Australia. So when the objectors proffer the theory that customer defection risk will doom parity surcharging, they have to account for the evidence. You can't just ignore the evidence. And the evidence tells us that it will take hold. It will take hold.

What do we have? We have merchants here saying, oh, we're not going to do it. Well, that's what they said in Australia. And every excuse that they've come up with for why

what happened there wouldn't happen here falls like a rock.

The other one that the objectors have proffered is that well, parity surcharging can really only happen where there had been differential surcharging. So they would explain away our evidence of widespread parity surcharging by saying well, those folks had been doing differential. But if you look at these hotels, not one of them -- all of them are doing brand-wide parity surcharging. Not one of them began their surcharging lives during differential surcharging. And we know that from comprehensive AmEx data.

So the theory has to be able to survive the evidence and it just doesn't. It doesn't. And my concern is that the other side of the argument here is all based on just sort of intuition, and our side is based on evidence.

There's one other suggestion that objectors have made to try to explain the evidence of widespread parity surcharging in Australia. I would be remiss if I didn't mention it. And that is the notion that merchants do it online, that, well, it's a niche practice, surcharging in Australia, and people just do it online, a facet of their business.

But if you just think about it for a moment, that really doesn't hold water because if the risk you're concerned about is customer defection, then I would submit the last place that you would do parity surcharging is online because

it's so easy for customers to defect. You can go from Amazon to iTunes with a click of a mouse. Right? But if you wanted to go from Home Depot to Lowe's, you have to get your bags, get in your car, it's a much bigger deal. And there's no evidence, there's just no evidence that surcharging is more prevalent online. So all of that evidence just, I think, is so strong in favor of our relief.

And I'd like to focus on the indicative aspects because some of the criticism that we come in for in the objection papers is that the relief here doesn't do anything to foster competition inside the credit card space, you know, that it's totally reliant on the dynamics of moving people to debit and so forth.

And there's something getting lost here. We've mentioned in a couple of our submissions now that the parity surcharging relief that's provided for in this agreement and the relief that will grow out of a Justice Department victory, should they be victorious in the trial, if you take those two strands of relief and put them together, that they open up tremendous competitive opportunities where the whole is far greater than some of the parts.

And there's an example that we gave. These briefs are lengthy. But in our reply brief in the context of Macy's, and what we said there was if Macy's doesn't want to surcharge its own co-branded card, what it can do is it can impose a

parity surcharge on all credit cards, say 2 percent, whatever, and say, but if you use your Macy's card, the surcharge is on us, we'll take it off the bill. And that would have the effect of steering volume to the Macy's card, a good thing from Macy's perspective. And it also gives people who want to use a resolving credit a surcharge-free option, which is a very large part of the critique of our relief, that we're not affording a surcharge free revolving credit card option but there you are in that example. I think you see that. And that's kosher under the settlement agreement, this example.

And what I just wanted to spend a minute on here is thinking about the opportunities to expand that basic concept, because it goes far beyond code brands. You could have Discover come to Hyatt or my client Marcus hotels and say, how about this: Surcharge everybody at 2 percent and we'll advertise that if they use their Discover card at the hotel that the surcharge will never appear on their monthly statement. The surcharge will never appear on the monthly statement. It might be at the point of sale but they'll never actually have to pay it. And it'll look something like this. We put a slide up, this is a mockup, it's not -- you know, this is not a real deal, we didn't do a commercial negotiation here.

But it informs the consumer that Marcus imposes a surcharge, tells them something about why and tells them if

you use Discover card at Marcus hotels, the surcharge is on us. And I think that there's a couple of powerful implications here that weren't mention. One is that you're giving the cardholder, you're giving the consumer a surcharge-free option for using revolving credit cards if you buy into the theory that to not do that would court customer defection risk, and we don't buy that theory for the reasons that I've talked about in Australia where just having pure parity surcharging obviously is not costing anybody lost sales. So I actually don't buy that theory. But if you do buy that theory, here's a surcharge-free revolving credit card option.

So in that sense, it ameliorates the customer defection risk and it makes it easier to do parity surcharging.

THE COURT: What is the benefit of this settlement if you're wrong and merchants, large merchants in the United States and small decide that they there's resistance to parity surcharging, and you have this settlement which limits the rights of merchants to adjudicate through various means their complaints that arise out of their merchant agreements with American Express and they don't get the surcharge because it, as a practical matter, has resulted in consumer resistance? So what's the benefit that has now accrued to the merchants who are covered by this agreement?

MR. FRIEDMAN: Okay, your hypothetical asks me to assume that parity surcharging which is ubiquitous in Australia is just is a nonstarter here.

THE COURT: I've never been to Australia. I don't know how consumers think in Australia. If you'd like to send me there, you know, so that I can conduct a survey, that would be fine. But I'm talking about -- Australia is a -- it may be a large country geographically but it's a small country in terms -- and it's monolithic as opposed to the United States which is more heterogenous. You know, the middle is different from each of the ends, the south is different from the north. There are all kinds of issues that play in the United States, in terms of consumer loyalties and consumer preferences and regional preferences and so forth that I can't even imagine. We could write an encyclopedia on the subject.

I'm just asking you what if your theory is not applicable or the Australian experience is not applicable to the market here, the heterogenous market in the United States, then what has been gained for the merchants as a consequence of this settlement if it's approved.

MR. FRIEDMAN: First of all -- okay, I understand. First of all, I think that the heterogeneity that you're talking about supports the proposition that surely there will be pockets of commerce in which this practice is profitable for merchants. It's certainly profitable, it makes sense to

do it and -- but if it were -- like if you take -- if you're saying -- if the hypothetical is that merchants won't do it, like they can't do it, if there was a congressional, if there was a federal law that says they can't do it.

THE COURT: Let me be more practical. Let's say I'm buying a ticket from one point to another on an airline and I see that Airline A has a 2 percent parity surcharge, but Airline B, and that's a very competitive industry, has decided that it's going to benefit from Airline A's decision and it's not going to impose that surcharge and so I'm going to pay 2 percent less on Airline B on the same point-to-point trip that I would have taken on Airline A.

MR. FRIEDMAN: If that hypothesis were -- if that were correct, everybody would be Southwest, bags fly free, but they're not. But they're not. And we know Southwest has the bags fly free. You know a lot more about the airline industry than I ever will, but that bag, if you checked two bags on Delta or United or whatever, that's like, that as a percentage of the ticket, I think somebody did 13 percent of the average ticket or something like that but they don't move that much more --

THE COURT: I'm asking if they decide to compete on the surcharge, you know, it's -- obviously it's more complex than the simple hypothetical that I gave you. But if they decide to compete on the surcharge and there's pushback on

Airline A, they can go back to not surcharging so that they're not at a disadvantage on price. You know, when you go from -- as you said, if you click on Airline A and then you click on Airline B and Airline B isn't charging the surcharge.

MR. FRIEDMAN: But what I'm trying to say, your Honor, is that today you click on Airline A and you're paying for bags, you click on Airline B and it's Southwest and you don't pay for bags. And Southwest isn't eating everybody's lunch. They're doing okay with the bags fly free but it hadn't swept the industry. And that's the point we were making, too.

I know you don't want to talk about Australia, but why wouldn't Marriott hotels say, we'll surcharge free? On that theory they would just, they would eat up the whole industry, everybody would come flocking to them if that theory were right. The problem is the theory is wrong. It is pure theory. And this is evidence, we have evidence.

And further, when you apply it in the context like on the slide that you see in front of you, it's a form of surcharging that very much does lead to competition inside credit cards. And any merchant can do it. And the restaurant that you talked about in the earlier hypothetical, they should be able to do a deal with their credit card companies to have the surcharge come off.

You know, Professor Hemphill asked the objectors,

suggested that it would be useful if they could account for the Australia evidence. And I think that was driven by his understanding that if you're going to say well, Australia is different, that's fine, but tell us, it's different because what. It's different because one thing or another and they don't have an answer. So I don't think we can just ignore it.

We also have other indications domestically. We do see surcharging all the time, we see it in the form of convenience fees. We see liveries and taxies surcharging. I just flew into Newark airport this weekend, they charge $5.50 more. If you take a taxi now into Manhattan, $5.50 extra charge if you pay by credit card. They jump through certain hoops to make that legitimate under Visa's existing rules and to not run afoul, to not sort of front run the settlement that we have here. But it's going to take off. It's going to take off.

The other side of the equation, though, to your Honor's hypothetical is the value of what's being given up. What's being given up by merchants here is the ability to challenge these rules. This idea that they're sort of the entire American Express rulebook is getting sort of cart blanche forever in all of its applications is just not the case.

THE COURT: Well, Professor Hemphill had some issues with parity surcharges. And what's the difference between

parity and equal surcharging?

MR. FRIEDMAN: So his use of -- his phraseology was new to me. And I think, and I can stand corrected here, I think what he meant by that was that equal surcharging, that term was where the merchant had the option of differentially surcharging who was choosing to do it and was using parity surcharging for the situation that would apply here, where the merchants only -- I don't know. I don't know. But I have to say I don't really understand, I didn't understand, I found that confusing. I found most of his report clear as a bell, I understood it, but I didn't get that.

THE COURT: Go ahead.

MR. FRIEDMAN: So the virtues that are associated with differential surcharging engendering competition -- if you look at this, going back to this slide, that's a very valuable slot to be in where Discover is. That's saying steer traffic our way. Right? Customers are going to flock to it.

Mr. Hochschild, Discover's president, came in here during the trial and said Discover wants to have some way that by reducing its overall costs to merchants that it can gain volume. And the MDPs and the rules that existed from the other networks, they precluded that.

THE COURT: Does the post settlement agreement present a carve-out from the MDPs for the time of steering that is involved in this discover ad?

MR. FRIEDMAN: No.

THE COURT: Because this is a form of steering.

MR. FRIEDMAN: This is. As I said, this is a confluence of --

THE COURT: You can do this in Australia maybe.

MR. FRIEDMAN: This is a confluence of the DOJ relief, if they are victorious.

THE COURT: So now I have to figure out what's going on in that case? I don't even have their paperwork yet.

MR. FRIEDMAN: I know. The trucks will be arriving tomorrow with the boxes.

THE COURT: They have to come in through the loading dock.

MR. FRIEDMAN: But this model, this slide that's up here does presuppose absolutely this is a form of steering that would require the MDP relief. However -- Scott hit the next slide -- this one does not. This is Discover, unilaterally without merchant involvement could come out with a card. We came up with the It's On Us card from Discover, all your credit card surcharges are on us. You use this card, we'll absorb the surcharge. It's a terrific competitive position. It makes surcharging easier for merchants, if there is something like this out there in the marketplace.

THE COURT: You know, I see a revision in the merchant agreement for American Express with merchants if

that's the consequence, that this -- I can imagine when there are renewals, based on my seven weeks of experience with the bench trial, that, that American Express -- and I'm not their lawyer, obviously -- that American Express might find something like this to be in effect a form of steering on the part of not Discover, which they can do, but on the part of a merchant which accepts both Discover and American Express.

MR. FRIEDMAN: Well, I'm glad you said that, your Honor. What that reflects is an appreciation of the potency of this tool and they would react to it, that they would want to react to it by shutting it down. And I don't disagree that they might. But they can't. But they can't.

This is unilateral action by Discover that is doing -- it's nothing different than Discover -- Discover can do its cash back, but they're saying wherever there's a surcharge, if you use this Discover On Us card, we'll eat the surcharge and we'll give you a rebate.

And what our settlement agreement says is that the amount of the surcharge across all brands has to be the same, it has to be parity, after accounting for all discounts and rebates that are offered at the point of sale. And this rebate is happening not at the point of sale, Discover's advertising it, Discover's delivering the rebate on the monthly statement.

And I'm pretty confident that American Express isn't

going to disagree. This doesn't violate anything and there's nothing that American Express can do to make it violate anything. And the consequence is that what you're going to have is competition, it's competition inside the credit card industry, it's steering, it's effective steering. And of course, the possibilities are even broader if the DOJ prevails.

THE COURT: So this could result in going back to other, Visa and MasterCard could embrace the same idea.

MR. FRIEDMAN: Yes. Yes, let the bidding again. Yes, we'll pay half your surcharge, we'll pay three quarters, we'll pay the whole thing. We'll pay the surcharge, whatever -- let's say Discover is sitting around saying, you know what, we don't have deep enough penetration in airlines. AmEx is eating our lunch on airlines. They own the airline space, them and MasterCard. Let's do a card that says whenever you incur a surcharge on an airline, it's on us. The possibilities are endless, it's competition. It's competition. We should be welcoming it. And it makes it easier.

So if the supposition that the objectors have proffered, and Professor Hemphill was sympathetic to this concept, that it's very hard to get surcharging going if you're not offering a surcharge-free option to revolving credit card preferring people, this does that. This does

that. That's what I really wanted to convey.

I'm going to wind down now --

THE COURT: Well, do you have more to say.

MR. FRIEDMAN: I do.

THE COURT: Well, let me hear some more.

MR. FRIEDMAN: Okay. On other issues, though, this is the -- the other -- okay, so here's what I want to talk about that rises to the level. If you're going to look at the settlement, under the law what we have to do is take the value of the settlement and compare it to the alternative. It's a comparative analysis. We have to look at the alternative. So let's take a moment and look at what happens if the settlement is rejected. So step one is we go into that giant appellate popcorn machine again.

THE COURT: You're going there? Everyone's going -- I assume --

MR. FRIEDMAN: Well, with that one, I'm not troubled by that one. I mean, I don't mean to be hubristic. If we're going up on a settlement, it would be one thing. What I'm talking about is on the motion to dismiss in favor of arbitration, Italian Colors redux, that's a load, just speaking from personal experience. And --

THE COURT: I think they'd love to see you up in the Second Circuit and the Supreme Court. Italian Colors, the name, it has appeal written all over it.

MR. FRIEDMAN: And I want to get my batting average in the Supreme Court up to 500. But --

THE COURT: We all have dreams. But go ahead.

MR. FRIEDMAN: So that's one road and I had spoken a little bit about that earlier, that's the class road. Let's talk about for any given merchant plaintiff. If the settlement is rejected, they can go seek differential surcharge or whatever. And most of the objectors haven't told us what they're interested in, but they can go under the dispute resolution provisions in their contract, and for most folks that's going to be arbitration.

So first they have the merits risk, they have to convince the arbitrator that they're going to win on the merits. And American Express is going to say, and your Honor has had some taste of this here in the trial, they're going to say if you allow this steering practice on an unfettered basis of American Express cards, then that's going to really cripple our ability to provide this differentiated service which is pro competitive value.

That defense is going to be more powerful in the differential surcharge case I submit than it has been here. But then say that the claimant gets past that level, now they're at the remedy stage. Now they're telling an arbitrator, let's say it's Home Depot, that they need to have unfettered differential surcharge of American Express cards,

the ability to do that across all Home Depot stores. And just like in this trial, you had Mr. Chenault come in here and others and tell you about what much less potent forms of steering would do to their brand. This arbitrator is going to be told that if he rules that way, it's going to cost thousands of jobs, I don't know, billions in market capitalization, whatever their argument is going to be. I'm just saying it's no walk in the park. It's a very heavy lift.

Let's assume they get through all that and then they have an arbitrator who is actually prepared to do that. Then what happens? Realistically on Planet Earth that case settles, that's what happens. The merchant had some leverage, they use it, they use it to settle the case for more than they think that they could have gotten from the damages suit alone. It's a confidential settlement and that's it. There's no positive spillover effects. There's nothing to benefit any of the other 6 million merchants. We have 6 million merchants in this class, none of them benefit a lick from that private confidential settlement.

So those are the two things that we're weighing here, the tremendous competition unlocking value of the surcharging relief in the settlement agreement, which is supported by evidence. And I understand the intuitions. I'm not saying the intuitions in themselves, they're crazy to have, I get them. But if they don't withstand the evidence,

then they shouldn't guide the ruling. That's my fundamental position.

I'm already leaving Mr. Korologous less time. If it's okay with you --

THE COURT: I'm going to give him his 20 minutes.

MR. FRIEDMAN: Okay.

THE COURT: Because I've asked you a lot of questions and so if you have something more to say, please say it.

MR. FRIEDMAN: I'm happy to say there are legal objections that are raised and I think that it's kind of natural to raise those then on the rebuttal case. So, for example, the due process objection, Rules Enabling Act objection, prepared to speak about all those, it's kind of a reply briefing for me to get into it here.

THE COURT: Okay, why don't you wait until the end.

MR. FRIEDMAN: Then the only other issue is the attorneys' fee application. If you're just as happy with us putting that to the end, because we've said everything in the papers, there's no surprises.

THE COURT: All right. Thank you very much.

MR. FRIEDMAN: Thank you, your Honor.

THE COURT: Okay. Mr. Korologous.

MR. KOROLOGOUS: Good morning, your Honor.

THE COURT: Good morning.

MR. KOROLOGOUS: Philip Korologous for American Express.

As the court knows, after a lengthy investigation the Department of Justice in 15 plaintiff states chose not to challenge American Express's prohibitions against discriminatory surcharges. We obviously believe that was both a pro consumer choice and the right choice by the Department of Justice. But the class in 15 individual merchants did challenge our parity surcharging requirements. It required parity even with debit cards. AmEx has heard the concerns of its merchants but it also must protect its differentiated services model. It's careful evaluation of the situation has led it to believe that there is a way to give merchants a surcharging option that would not eliminate our ability to provide valuable differentiated services to consumers and to merchants.

This is a major concession for American Express, especially given the weaknesses of the merchants cases, especially given the weaknesses of their cases on surcharging, including the weakness in the class's case in light of the Italian Colors decision on arbitration provisions.

As the court knows, the company was and remains determined to fight to preserve the rest of its nondiscrimination provisions as critical to the companies survived. We believe that our compromise on surcharging as

well as our compromise on the contractual rights to enforce individual arbitration provisions are a significant value to merchants.

On the other hand, and as I'll discuss further, we've made clear that this is as far as we can go to achieve a compromise that would apply classwide.

This settlement is both procedurally fair and substantively fair therefore meeting the standards for approval. As the Second Circuit said in the Wal-Mart case, there could not be any better evidence of procedural integrity than a history of aggressive litigation and impassioned settlement negotiations before a mediator. That's what happened here. The class wanted more relief, we wanted less. The class felt it had the right to proceed as a class on injunctive relief claims. We disagreed. Luckily, we had the good services of Ken Feinberg, without whom I don't think we would be here today because he kept bringing us back to the table. As he noted in his affidavit, it would be a real understatement to say that the negotiations were arm's length and hard-fought.

Some objectors have claimed that because of the Italian Colors case the class was fatally wounded and that class counsel entered into the agreement with American Express to get paid their $75 million in attorneys' fees. But as the Second Circuit noted in the McReynolds, primarily because

class counsel left the issue of attorneys' fees to the discretion of the district court, there was no indication that the settlement was the product of bad faith or collusion. The same is true here.

We have not agreed to pay $75 million, we've agreed to pay whatever your Honor orders. And if that amount is much less, the class is obligated to continue with the settlement even if they do not get what they're asking for in their attorneys' fees. The settlement is substantively fair. In applying the Grinnell factors, the Second Circuit has noted that there is a range of reasonableness with respect to a settlement but recognizes the uncertainties of law and fact in any particular case.

The settlement responds to merchants' requests for some changes to the MDPs by allowing merchants to surcharge credit and charge transactions while not surcharging debit transactions. While AmEx continues to believe that surcharging is bad for consumers, we responded to the call for some changes to our MDPs with the most reasonably able in our belief to provide while maintaining our ability to provide our differentiated services.

The settlement also resolves what Judge Gleeson referred to as the American Express problem in his approval of the settlement in 1720. There your Honor will recall many of the same objectors that are here complained that because of

the juxtaposition of Visa and MasterCard's prohibitions on any surcharge and debit cards a prohibition that continues today even after the 1720 settlement combined with American Express's requirement that if there is a surcharge on American Express cards it needs to be the same across all cards, credit, charge and debit cards. Those objectors complained in 1720 that that meant with American Express's rules and the no surcharging obligations for debit from Visa and MasterCard, they could not get to any of the benefits under 1720.

This settlement unlocks that. This answers that. It may not be a complete answer for all of the issues that merchants have raised about surcharging. It doesn't resolve state laws. It doesn't resolve the complexities of the competitive environment. It doesn't resolve the technology issues. But as Judge Gleeson noted, this is one issue. This is across the board benefit for all merchants whether they choose to engage in it or not, whether they have the ability to engage in it or not. It is benefit for all merchants and therefore since it applies to everybody satisfies Rule 23 and the due process standards under the Dukes case. It is a benefit for the class that is approvable. It is but one piece of the mosaic, as he called it, to solve the many issues that merchants are complaining about. But it is one piece in benefit for merchants.

THE COURT: Well, let me ask you this, and perhaps

you can address the issue in terms of class certification under Rule 23, having to do with a necessity, I think with (b)(2) class, to have commonality and typicality. And I spent almost seven weeks listening to testimony, you were there for most of it --

MR. KOROLOGOUS: I was, your Honor.

THE COURT: -- about the customized MDPs that you have with certain merchants at American Express.

And my question is: Is there really sufficient commonality and typicality for class certification where you have many of the largest merchants in America who have national chains of stores where they have special terms in their MDP arrangements with American Express as opposed to the vast majority of small merchants who were simply handed the merchant agreement and told this is it, take it or leave it?

MR. KOROLOGOUS: Your Honor, there is typicality and commonality. The claims are related to aspects of the nondiscrimination rules that do apply across the board. Take surcharging and differential surcharging for instance. There are no agreements, negotiated or formal agreements, in which American Express allows American Express cards to be differentially surcharged against. There are none. We have been consistent with that issue across the board.

And the classes claims that that violates the antitrust laws. It is a claim that applies equally for all

merchants and therefore satisfies the commonality and typicality both for the class certification under 23(b)(2) and also the due process analysis that the Supreme Court has done in Dukes and other cases to satisfy that standard.

With respect to some of the differences, take Home Depot that operates in the ten or so states that have rules that affect its ability to surcharge. That's going to be true even if this case is not approved for settlement and even if, somehow, despite all of the hurdles to show relevant market that debit is not in the market so they can have a market where they argue that there is some level of market power the pro competitive effects of our steering -- of our non-steering rules generally but also of the no differential surcharging agreements, if they can achieve all of the hurdles they have to get through to win the case they still face ten states that have these no surcharging rules.

They still have competitors that might chose or even announce that despite what has happened in the settlement or despite what has happened in the victory in court, they're going to not surcharge, they are still going to have technology issues that need to be solved. That's part of the mosaic, as Judge Gleeson put it, that exists in the entire issue of the payments industry. This is but one piece of that mosaic. This is the piece that the class and the merchants believe benefits them.

Let's look at the issue, for instance, of whether debit is in the market more than there will be a benefit to substitutability between credit and debit. Look at the individual merchant's damages case. In their case, it is premised on the ability of stores to get consumers to shift from credit and charge cards to debit cards. Their entire supposed overcharge theory which we believe has a lot of flaws but it is premised on calculation that builds off of a PIN debit rate and says there are a few other things like the uniqueness of American Express and fraud that we're going to add to that rate, but it is driven by substitution from credit and charge cards to debit if steering and surcharging is allowed. That's the very kind of substitution that we believe in our case and that we've discussed with your Honor ought to be showing that debit is in the market. But it also goes to the issue of whether there is value, in their view, in their submissions in this court as to whether there's value to this settlement.

And again, it's a piece of the mosaic. It is a benefit to them, they believe, to be able to do this. It's not going to solve all of their issues, nor can it. This court doesn't have the ability to eliminate ten different states' laws. It doesn't have the ability to solve the technology problem. It doesn't have the ability, nor should it, even contemplate saying that merchants should not compete

with one another about whether they're going to surcharge their consumers or not.

THE COURT: I walked in here, I thought I was powerfied. Now I know I'm just here for the ride. Mr. Korologous, I appreciate you delineating all the ways I can't do things.

MR. KOROLOGOUS: It's not to say it's limiting on your Honor's powers, but it's simply a recognition of the various issues that merchants complain about, including in their objections here that do not go to the issue of whether this settlement is approvable, but whether they could get more.

Many of the objectors argue that essentially from the base, including with respect to their arbitration clauses, that they want to do it on their own. They want to opt out, they have the ability to do better than this. But Rule 23(b)(2) exists. It exists to create non-opt-out claims. This case has not raised concerns such as the objectors raise under Dukes of settling a case that involves both injunctive relief and damages. Damages are preserved. Any pre rules change conduct by American Express for which we're found liable for are damages that every member of the class will continue to preserve.

THE COURT: Well, I understand the theory behind the Supreme Court's decision in Dukes. I think we have a very

different situation here, quite frankly. I'm concerned about, what the tradeoff that was negotiated through Mr. Feinberg, which is on the one hand the merchants, if they won, get their parity surcharge; on the other hand, American Express gets the tradeoff of limiting for all intents and purposes, any future challenges to the MDPs. Isn't that basically right?

MR. KOROLOGOUS: Yes, but there's a footnote.

THE COURT: Including merchants who aren't even currently accepting the American Express card. In other words, future draft picks.

MR. KOROLOGOUS: Correct.

THE COURT: So I go into business tomorrow selling flowers, which a lot of Greek people do. All right. And I take the American Express card because I'm up on, I'm up on Madison Avenue and 85th Street where people pay a lot for flowers, but I can't challenge, I'm limited as to what I can do in terms of challenging the MDP.

MR. KOROLOGOUS: In that instance that's correct, your Honor. And as part of the relief that American Express is willing to enter into providing for the first time this kind of surcharging that does not require parity with debit surcharging, American Express requires uniformity across the class for that relief. That means not just the existing merchants today but should a new merchant come along. There are a number of cases we cite in our brief where future

members of the class are bound, one of the Giuliani cases, one of those cases, but there's certainly is the power in approving the Rule 23(b)(2) settlement to settle claims including for future class members.

THE COURT: And that could affect many thousands of merchants over a ten-year period.

MR. KOROLOGOUS: It certainly could but they would be getting the same benefits as the class of merchants that exist today get. They would get the same benefit of proceeding under the revised rules with the right to surcharge credit and charge cards at one even level among that group while not surcharging debit cards.

THE COURT: Aside from the Visa/MasterCard settlement, has there ever been a settlement that had the kind of reach in terms of the numbers of entities that were affected, commercial entities that were affected as this settlement would apply to, to your knowledge?

MR. KOROLOGOUS: I'm sure there have been. They don't spring to my mind. Perhaps discussions with my group and when I stand back up this afternoon, I'll bring to light some of the broad instances.

THE COURT: I'd be curious.

MR. KOROLOGOUS: But the issue, again, in those cases, as well as in this case, is whether there is uniformity of the claims that are brought and the relief that's being

granted in the settlement. And that's the analysis under the due process consideration under Dukes and under the language of Rule 23(b)(2), including as identified in the advisory notes of that decision.

THE COURT: Well, I mean, the objectors constitute a wide range of major commercial entities and in this country and so I have a concern that if so many entities which have such a considerable role in the marketplace in America object on various grounds to the settlement that it may be that while the smaller merchants, restaurants, the florist and others don't find it to be objectionable, at least according to what we have in the record here, but many of the larger merchants find it to be objectionable that there's something more to it than meets the eye from my standpoint and I'd be concerned about that.

MR. KOROLOGOUS: Well, you're right, your Honor, there are two ways to look at it in terms of the absolute number of merchants. There were millions of notices sent out. There are, depending upon how you count it, maybe 4 million top of chain merchants, 6 million if you count locations. There are objectors here. Again, there's a different way to look at them. There are either about 350 or if you group the Blue Cross entities together, there are about 175, I believe, a tiny fraction of all of the merchants.

The other way to look at it is on a charge volume

basis where the percentage is much higher because the number of merchants that are here are large merchants in a variety of industries. But, again, it comes down to application of the rule and whether the standards are satisfied of whether the injunctive relief is relief that will apply to all merchants, not whether they will all then choose to do something under that. They will have the right to chose that. They will now have the option that they did not have before.

And as Judge Gleeson said and as other cases have recognized, that kind of an option is an advancement for them that is sufficient when you go through and satisfy the Grinnell factors, which as our papers say, and as the classes papers say are satisfied here, that is sufficient under Rule 23(b)(2), and under the due process considerations to approve this settlement. Thank you, your Honor.

THE COURT: Okay. Thank you. All right. Now, I just wanted to point out that I'm allowing 90 minutes for the proponents rebuttal and some of these issues might be further flushed out during the rebuttal, so let's move on now. What I'd like to do is I've allocated 35 minutes for the Target objectors group and National Retail Federation. And according to my notes, the spokesperson will be Mr. Cantor.

MR. CANTER: Yes, your Honor.

THE COURT: Just state your appearance for the record, if you will.

MR. CANTER: Your Honor, my name is Michael Canter and I represent the group of Target objectors and the National Retail Federation. And if I may, your Honor, we have a couple of demonstratives and we've printed them out as well put them electronically. And if I could pass those up to your Honor at this point.

THE COURT: Sure, give them to my clerk.

MR. CANTER: Thank you.

MR. FRIEDMAN: Your Honor, may I control the screen?

THE COURT: Yes. There you go.

MR. CANTER: Your Honor, we represent the 18 Target objectors and the National Retail Federation. And as your Honor has already noted, they represent some of the largest national retailors in the country. The National Retail Federation is the leading retail industry trade association. We are coordinating our arguments this morning for time, et cetera, with the 7-Eleven objectors, the individual plaintiffs and with Home Depot.

My argument is going to focus on the implications of Italian Colors as well as why this settlement does not pass muster under Rule 23(a) and 23(b)(2).

The first reason that the settlement must be rejected is it violates the Supreme Court's decision in Italian Colors. As your Honor knows, Italian Colors holds that a contract right to have a claim resolved through

arbitration is a substantive right and it's protected by the Federal Arbitration Act and the Rules Enabling Act and Rule 23 cannot be used to abridge that right. This settlement would do just the opposite. It would use Rule 23 to strip our clients of their contractual arbitration rights.

The proponents point to certification of the mandatory class in 1720 and say that this class should be certified as well. This case is not like 1720. As your Honor probably knows, Visa and MasterCard contracts, merchant contracts do not have arbitration clauses. Italian Colors was not an issue in Judge Gleeson's courtroom, it is an issue in this courtroom.

Soon after Italian Colors was decided, AmEx moved to dismiss or to compel arbitration in this case. It's motion accurately summarized the holding in Italian Colors. And this is what it said: Here the Supreme Court has already ruled that the American Express arbitration clause, including specifically the class action waiver, must be enforced. But the merchants have the same arbitration rights that AmEx has. And why is that? That is because AmEx contracts are mutual.

Let me bring to your Honor's attention, and we've submitted this with the objection of limited brands, that the clause in the limited brands contract, any claim that has not been resolved pursuant to Section A or B -- A is the meet and good faith provision and B is the mediation provision -- any

dispute that's is not resolved through A or B shall be resolved, and we've emphasized this, upon the election by you or us. So both parties can take the other to arbitration.

Neither AmEx nor class plaintiffs dispute that this settlement, if approved, would eliminate that arbitration right. The Target objectors assert that the settlement must be rejected because it would use Rule 23 to strip merchants of their arbitration rights and that violates Italian Colors and the Rules Enabling Act. The class plaintiffs argue that they have the authority as class representatives to weigh the arbitration rights of absent class members.

Our clients never authorized class plaintiffs to waive their arbitration rights. Instead, our clients have actually invoked their arbitration rights and their letters to American Express have been attached to their objections.

The class plaintiffs as Rule 23 representatives have no independent authority to waive the arbitration rights of absent class members. This is because Rule 23 does not grant them that power under Italian Colors. In addition, the class plaintiffs are not even valid class representatives. They waived their arbitration rights years ago. The class plaintiffs are not adequate because they do not have the same substantive arbitration rights as the absent class members.

These same facts create an irreconcilable conflict. The class plaintiffs never wanted to arbitrate their claims

against American Express, they wanted to litigate. As you've heard, they fought for years for the right to litigate but lost in the Supreme Court. Having lost, the class plaintiffs now want to bargain away the arbitration rights of the absent class members.

This is not a circumstance where the class plaintiffs and the absent class members share the same claims but disagree over the terms of settlement. This is a case where the parties do not have the same claims and that's an irreconcilable conflict and for that reason settlement must be rejected.

Let me turn now to 23(a)(2) and 23(a)(3). As we've said, most of the absent class members all have contractual rights entitling them to unique ADR processes, alternative dispute resolution processes, and to individual resolutions of those disputes with AmEx. The class representatives have waived their rights and therefore under Rule 23(a) they do not share the claims of the class and therefore the settlement fails 23(a).

The settlement class also fails (a)(2). This is because the court cannot look at the AmEx merchant agreements that the class plaintiffs have and determine from them what the ADR rights of all of the class members are. It was established at the government trial, as your Honor knows, that AmEx negotiates different contracts with different merchants.

And we looked at some of the transcript, and this slide just summarizes some of the testimony that you heard that indicates, as already mentioned here this morning, that AmEx negotiates with individual merchants.

That testimony did not focus on the ADR clauses, it focused on the nondiscrimination clauses. And that's because ADR was not an issue in the government trial. But the interest Target objectors and the National Retail Federation have submitted evidence that the ADR rights vary from merchant to merchant entitling different merchants to resolve their claims in different ways.

And this particular chart, this is a compilation of all of the evidence that we submitted for our clients on the objection. And of course down the right-hand side are the merchants that we represent and they are ordered in terms of size of sales. So Target is the largest. National Retail Federation is actually the smallest. American Signature would be the smallest actual merchant. And across the top are the different options for how -- the different -- I call it the different paths that a dispute resolution process could take. They all start, virtually all, the same way and that is you give notice, and we've done that. But the second column is an interesting provision. It says that, when you start a dispute resolution with AmEx, you have to meet in good faith and try to resolve that. And I contend there is not a court in this

country that wouldn't enforce an obligation to meet in good faith that AmEx has put into its provisions.

Then you get to mediation and there are different options on mediation. Some of the merchants have mandatory mediation. Others have mediation by election, meaning, one party can require the other party to come to mediation.

And then in the last of the three columns is mediation by agreement where both parties have to agree. Fail to resolve, you go on to arbitration. And it follows the same pattern as mediation. There's mandatory arbitration, elective arbitration, where one party can compel the other to arbitration, and then arbitration only by agreement. The colors indicate which merchants have the same path. So Target has a unique path. No other merchant in our small sample, our client group, has a contract like Target's.

Macy's has its own path. Even though it's the secretary largest, it has a path that's different than Target's. TJX, which is T.J. Maxx, and a couple of other stores brands like that, has its own path and Staples has its own path and Limited Brands has its own path.

Then you get into a group of companies, and again coming down in size of company, where the next three companies Bon-Ton's, Office Depot, and OfficeMax, all have the same path in their contracts. And these are all negotiated. And Macy's and Target specifically negotiated these provisions to meet

the kind of dispute resolution that they wanted, as the TJX Staples and Limited Brands, L Brands. Ascena and Saks and Chico's have their own path in their contracts. And the National Retail Federation has it's own path.

And at the bottom we have the Morales declaration that was filed in support of the motion to compel arbitration by AmEx, and that's for the smaller merchants. And what you'll note is that the smaller merchant path is actually different than all of the larger merchants. Just to give your Honor a sense of what we're talking about, because I know you've heard a lot of testimony that we have not been privy to as objectors, but our largest client Target, for example, has $75 billion in retail sales annually. Macy's has 25 billion. American Signature has 1 billion. All much larger than the class representatives here who I believe the Morales declaration was intended to represent what their arbitration rights looked like in their agreement. So millions of merchants who have different arbitration agreements, different ADR paths than the larger merchants.

Now, this isn't all of AmEx's millions of merchants, these are the only contracts that we have privy to. And we thought once we looked at them and we saw them, what we realized is that because there has to be commonality in an (a)(3) class action, (a)(3) requirement, that the court has to be able to look at the representative's contract and answer

the question what are the ADR rights of the class. It's pretty obvious from just this sample that that can't be done and for that reason (a)(3) isn't satisfied.

THE COURT: Could you just explain something on this chart? The difference between arbitration at election of either party and arbitration by agreement, how did the -- I understand the election. But what's arbitration by agreement? Does it require both sides to agree to the arbitration?

MR. CANTER: It does, your Honor. That's exactly what it means.

THE COURT: And so Target has a merchant agreement with American Express where it could reject arbitration and go to litigation. Is that right?

MR. CANTER: It could.

THE COURT: As with the case with Macy's and T.J. Maxx?

MR. CANTER: That's correct. We believe that what the Supreme Court is saying in Italian Colors is it is not limited, the holding is not limited to simply arbitration. What the court is saying is that when you make an agreement, like any of these agreements, that provide for how your dispute is going to be resolved, that that is an enforceable substantive right because it's negotiated in a contract and the Rules Enabling Act protect that substantive right. That also happens to coincide with the Federal Arbitration Act

which provides special protection for arbitration. So we believe that Italian Colors reaches all of the variations that are represented by our clients.

THE COURT: So is it your view that if this class settlement agreement is approved, that it will somehow affect Target's right to reject arbitration and go to litigation?

MR. CANTER: It will affect Target's rights to have good faith negotiations with AmEx over issues such as surcharging. If Target desires to have a conversation with AmEx about surcharging as part of its larger contract negotiations, we want to surcharge, we want the right to parity surcharge, we don't really care about surcharging, we want something different than that.

Target, which American Express absolutely wants to be in, has the leverage to have those conversations and they agreed when they enter this contracted that if they have a dispute they're going to sit down with each other in good faith and try to resolve that. This settlement strips that away.

THE COURT: I'm trying to understand why that is if at the end of the day after mandatory mediation Target can turn around and say, we decided -- we're the, you know, 800-pound bully in this relationship and we're just going to go to litigation and we're not going to go to arbitration.

MR. CANTER: They could do that but for the

settlement. This settlement strips their right to go to litigation because of the release that is imposed upon Target.

THE COURT: All right. So you're saying that this settlement, proposed settlement, effectively modifies the merchant agreement between Target and American Express in that regard?

MR. CANTER: It absolutely does. They negotiated their relationship, including how they would resolve disputes with each other. This settlement comes in in the middle of that and changes it.

THE COURT: Go ahead.

MR. CANTER: The next two columns are interesting and I'm going to get to the last column in a moment, but the second-to-last column is the provision that was sustained in Italian Colors which says you can't participate in the class. These are the merchants that have that provision in our group.

And the last column indicates the merchants where their contracts reserve to them the right to accept the relief or reject the relief and not to participate at all in the settlement. And I'll get to that in a just a moment.

I just want to bring to your Honor's attention why this kind of evidence was not brought to your Honor's attention as part of the motion for settlement approval. And there's a footnote in the material that the class has submitted which is very telling and that is that they did not

take discovery of the kind of information that we've just put in front of your Honor. So they had no way of knowing what the real facts were that either support or required denial of the (a)(2) and (a)(3) issue.

So because the alternative dispute resolution rights of all the punitive class members cannot be determined in one stroke, to quote from Dukes, the settlement class must be rejected. The third reason settlement must be rejected is that it fails to meet the stringent procedural requirements required by the Supreme Court's decisions in Amchem, Ortiz and Dukes for certification of a mandatory (b)(2) class.

Dukes establishes that it's the proponent's burden to justify depriving absent class members of their opt-out rights. Objectors have no burden. Dukes establishes that there is only one justification for a mandatory (b)(2) class and that's what Dukes calls an indivisible injunction. That's an injunction that provides identical relief to the entire class at once.

And the evidence of justification, the evidence of the indivisible character of the injunctive relief must be sufficient to support findings of fact and must be evaluated under the standard of heightened attention to that justification.

And the Supreme Court, of course, explained why, which is that the plaintiffs and defendants are now allying in

interest in terms of the settlement and you really don't have an adversarial proceeding.

THE COURT: Doesn't parity surcharging across the board provide that identicality of relief that the Wal-Mart decision requires for a (b)(2) class certification?

MR. CANTER: It does not. Parity surcharging affects different merchants differently. You've already heard about Macy's, we'll talk about that a little more. There has been no justification for why parity surcharging requires that every merchant be bound. Merchants can decide for themselves whether they want to surcharge or not. And they can decide to give a release.

THE COURT: But it's a tool that's available to all of the merchants who are covered by the proposed settlement. Right? I mean, you don't have to avail yourself of every benefit but it's a benefit that is available to every merchant. So that's the distinction between what you're saying and I would assume the argument made by the proponents.

MR. CANTER: Well, it's certainly not available to the merchants in those surcharge states. That's clear as a matter of law. There was a decision two weeks ago in Florida sustaining that statute.

THE COURT: I didn't know about that decision. I'm sure you'll tell me.

MR. CANTER: Your Honor, I actually have a copy I

can pass up if I may.

THE COURT: At what level was it?

MR. CANTER: District Court, Northern District of Florida.

MR. GERMAINE: We sent it. We sent it to the court. We sent it to you.

THE COURT: Thank you.

MR. CANTER: So the prediction that these statutes are going to fall was at least premature.

THE COURT: You don't have anything from the 11th Circuit yet?

MR. CANTER: No, that's just two week old.

THE COURT: Okay. Go ahead, please.

MR. CANTER: So as I said, we've got the non-surcharge states and we've got Professor Hemphill's conclusion that most merchants are not going to be able to take advantage of that. What I want to address --

THE COURT: He doesn't think it's clear that they would be able to because there's no data on whether they would or could.

MR. CANTER: And I believe that that is --

THE COURT: Except for Australia.

MR. CANTER: But that is particularly significant in view of the fact it's the proponents burden to bring forth evidence under heightened scrutiny which justifies the

imposition of a mandatory class.

THE COURT: They're arguing that the Australian experience with surcharging is instructive in that regard. It's not as if we're dealing without any knowledge about how the surcharging has worked in a major market. Australia is a major market. It may not be California, but it's a major market. So wouldn't that be supportive of that type of finding on my part?

MR. CANTER: My understanding is that that evidence is disputed. But beyond that point there is no justification for saying to a merchant, we've got to have every merchant in the country on this settlement for parity surcharging to be effective.

Any merchant can decide for itself whether it wants to be in this settlement or not and take advantage of parity surcharging and give the release that AmEx wants. There is no justification -- There's no necessity in the sense of an indivisible injunction that every merchant has to be in this settlement. The relief doesn't require it. The relief is individual.

THE COURT: But a (b)(2) class does require, there is no opt out in the (b)(2) class. Right?

MR. CANTER: Well, not on the face but there are courts that have allowed opt outs from (b)(2) classes.

THE COURT: Are you suggesting that this court would

allow opt outs from a (b)(2) class?

MR. CANTER: Frankly, I don't know how else you would vindicate the arbitration rights of the individual merchants that have those rights without allowing them to decide whether or not to protect those rights or to give them up.

THE COURT: Well, the objectors here represent a large portion of the merchant spend, all right, if you will. The spend of merchants in the United States.

So giving them an opt out would potentially eviscerate the benefit of this settlement the very large number of small merchants who are not opting out.

MR. CANTER: Two responses to that. Number one, that would be true only because American Express would choose to walk away from the settlement under those circumstances. It doesn't need to. Merchants who choose to stay in the settlement can do so, can provide the release and can exercise parity surcharging.

But more importantly, the Supreme Court actually addressed this issue. Section IV of the Italian Colors decision addresses the question of whether there is an exception to Italian Colors which says if you really need to have a mandatory class because the relief will only be effective on a wide classwide basis, is that a basis to override the arbitration rights. And the court answered no,

that the substantive rights supersede whatever benefit might come from the settlement and that the issue of how beneficial the settlement is, the Rule 23(e) issue, is not relevant to the (a) and (b) issues.

I want to draw your Honor's attention to the Macy's situation. And so Macy's entered into a co-branding relationship with AmEx that Macy's believes is very valuable. And here by the admission of the plaintiffs, Macy's would have to surcharge its own card and then plaintiff's begin to speculate and theorize about how Macy's can build a workaround around that.

And I have just want to show very quickly. So this is already actually been said here in the courtroom, but it says, Macy could offer to give back the money. That's not free. That's not easy, that's complicated, that runs the risk of consumer confusion. It runs the risk of consumer dissatisfaction. And the merchants are trying to tell Macy's how to run its business. And Macy's respectfully doesn't need that help.

So let me get back to the issue of justification. AmEx makes a very important concession in its reply brief in support of this settlement. And what it says is, that without the uniformity and certainty of a non-opt-out class, American Express has no incentive to continue with the settlement. This is no justification at all.

The Supreme Court in Dukes is very clear. This is all about the rights of the absent class members and the justification that is required pertains to the character of the relief. It has nothing to do with what American Express's wishes are or demands are or negotiated position is. The focus has to be exclusively on the character of the relief. And this relief doesn't qualify.

You heard the testimony of, I believe his name is Quagliata. He testified repeatedly. He said over and over again that AmEx will negotiate nonstandard, nondiscrimination provisions with merchants and they're willing to -- with companies, that they want to have as their AmEx accepting merchants, they're willing to have negotiations.

Paragraph 10 of the settlement agreement reserves to AmEx the right to continue having those negotiations. They can buy off the rights of certain merchants who they select and they can say, we're going to give you money if you want surcharge. If that is true, where is the justification for a mandatory class?

And then finally I want to bring to your Honor's attention, this was the last column on the colored chart. This is the provision from the Luxottica agreement. Luxottica is the company that runs LensCrafters and Sunglass Hut and all of that. This is the provision that they negotiated. And I have underlined and highlighted the relevant language which

says, if you wish to receive the consideration that goes to the class, then you deliver us the same release that the class gets. But it's Luxottica's option.

You've reserved the right to decline any remedies, and we agree that you've retained your right to pursue an individual claim that is not part of a class action.

So this looks like for all the world like an opt-out right, to me. And there's three of our clients that have these. And if these three clients have that right, why shouldn't every merchant have that right. Where is the necessity in the relief that it be indivisible so that it's imposed on every merchant?

THE COURT: So what you're saying is that if you're large enough you can negotiate an opt-out right but if you're not you're stuck? Is that what you're saying?

MR. CANTER: I can't say that because I don't know what all the agreements look like that American Express has. I've only seen 18 of them. And those 18 we've displayed for you. And three of them who actually are not very large, the NRF is very small in terms of the amount of transaction volume that it has.

THE COURT: What does Luxottica do?

MR. CANTER: Luxottica --

THE COURT: What is their business?

MR. CANTER: Sunglass Hut.

THE COURT: Yeah, Sunglass Hut.

MR. CANTER: And LensCrafters. And they have --

THE COURT: International chain?

MR. CANTER: International chain. They have about two and a half billion dollars in retail sales through their chain. They also have a lot of wholesale business. But through their chain that's what they have.

So let me turn to one last issue in the few minutes that I have, and that is the mandatory release. The release violates both Rule 23 and the due process clause. Dukes is clear, the only claims that can be resolved through a (b)(2) mandatory class are those claims that can be resolved through indivisible injunctions. And this release does two things. It resolves a whole host of unspecified injunctive claims and it releases a whole host of money damages claims.

It can't release, under Dukes, in a mandatory class, the claims for injunctive relief because there has not been the proceedings and the heightened scrutiny and the evidence to demonstrate that those claims can be resolved by an indivisible injunction. And the monetary claims cannot be resolved because Dukes simply prohibits resolving monetary claims through a (b)(2) mandatory injunction.

The proponents argue that that limitation in Dukes, that prohibition should be interpreted to apply only retrospectively and should not apply to prospective damage

claims, individualized damage claims. But that's not consistent with Dukes.

Dukes draws are very simple line. Indivisible injunctive claims, yes, those can be resolved if the proper demonstration has been made. But individualized damage claims can never be resolved. It says nothing about when those damage claims are or are not incurred.

So our problem with the mandatory release is we've gone through a long proceeding and we're going to go through a long proceeding today that's going to focus on the relief that the class gets the parity surcharging. And one of the things your Honor will be looking at is, is it indivisible in character. And if your Honor finds that it is, and we think you should not, but if you find that it is, then in through the back door with no scrutiny whatsoever comes all of these other claims that are resolved and all the injunctive claims and all the monetary claims.

So for all of those reasons we think the settlement must be rejected. We thank you for your time.

THE COURT: Thank you very much. Okay. I think we should take a ten-minute break. We'll take a ten-minute break.

(Brief Recess.)

(Continued on the next page.)

(In open court.)

THE COURT: All right. The next objector group will be the 7-Eleven objector group. And speaking for that group is Mr. Shinder, from Constantine Cannon.

MR. SHINDER: Yes.

THE COURT: Mr. Shinder, welcome.

MR. SHINDER: Good afternoon, your Honor.

THE COURT: Good afternoon.

MR. SHINDER: Jeff Shinder from Constantine Cannon, the 7-Eleven objectors.

Your Honor, the proposed settlement is the product of American Express exploiting a virtually defunct class case to engineer a settlement that protects it from the competition that matters, the competition it's most afraid of -- brand competition via differential surcharging. But this deal is worse than one that merely perpetuates the status quo. Because by proposing to lock in anticompetitive rules through a court approved settlement that includes an impermissible forward looking release, this settlement actually threatens to make a bad situation even worse.

Your Honor, for my clients the backdrop of this deal is deeply troubling. On the one hand, you have plaintiffs, who during the litigation phase of the case repeatedly said their case was about engineering price competition between American Express and rival networks like Discover, who now disavow the importance of that and contend that that

competition is comparatively trivial to the supposed benefits of parity surcharging.

On the other hand, you have American Express, who in the DOJ case claimed that softer forms of steering, of differential steering could threaten its very existence; but in this proceeding they are all too willing to agree to parity surcharging, which will lock in a situation where the differentiation they're afraid of will never happen. Against that backdrop, your Honor, this settlement must be rejected for three reasons:

First, it must be rejected because the proposed mandatory settlement class should not be certified for the reasons Mr. Canter stated;

Second, it must be rejected because the deal that offers merchants virtually nothing, a conclusion that Professor Hemphill found -- and I'll come back to that in a minute -- while releasing potentially forever valuable claims against differential, the rules that bar differential surcharging --

THE COURT: You don't really believe that it will release it forever? I mean, changes occur; markets change rather often and rather quickly and we have -- we don't have a crystal ball that these provisions won't be altered substantially in five or ten years that would lift the injunctive nature of the agreement as to the class. Wouldn't

you agree with that?

MR. SHINDER: No. Actually, your Honor, I would respectfully disagree with that.

THE COURT: Why?

MR. SHINDER: If the settlement is approved, there would be no incentive for American Express to alter the rules. The parity surcharging rules that is agreed to here, it's not protected by that at all. It protects them against the differentiation they're afraid of. And this release, because it's tied to the release in the MDL-1720 settlement, could potentially go on forever. And the release also reaches substantially similar versions of the rules and the future effect, claims concerning the future effects, getting to your, you know, the market may change. Well, the release reaches claims concerning the future effects of those rules, including future versions of those rules. So they would have no incentive -- as long as Visa and MasterCard stay within the MDL-1720, and they have this, they have no incentive to change the rules, and this could go on forever.

THE COURT: When an investor or an investor group decides that they're going to enter the credit card issuing market, that could change everything, couldn't it, if they decide that they're going to get in it? And that requires then that Visa, MasterCard, American Express, and Discover make adjustments to their business models. That's a

circumstance that could occur, if they saw the credit card business -- if there were a group of investors that saw the credit card business as, you know, fertile territory for profit.

MR. SHINDER: The scenario you postulated was about investors on the issuing market. The market in which they compete is the network market for merchants. There has been no material entry into that market since Discover in 1985. It is still the four brands. That's telling. And, yeah, we can speculate, who knows what's going to happen in 20 years. Of course I don't have a crystal ball.

THE COURT: Well, this agreement invites us to speculate, don't you think?

MR. SHINDER: And that's the problem. What I can tell you safely today, if you approve this and parity surcharging is the, you know, quote/unquote, law across the three dominant brands, they will have no incentive to change their rules. And if nothing else changes going forward, this release could go on forever. That's a problem. That's a problem. That's the third reason why this settlement should be rejected.

So let me just go back over some of those points. On the settlement class certification, you know, issues, we wholeheartedly agree with the argument that you heard from Mr. Canter -- and we will not burden the Court with rehashing

any of them -- but I want to address one question you posed to Mr. Canter, your Honor, which was the evidence from Australia, does it support certification of this mandatory settlement class? And the first thing I'd say about Australia, your Honor, is, you know, we are weary. We invite the Court to be weary about accepting Australia as being opposite to the United States, for various reasons, and we rely on our papers.

For the sake of discussion, let's say Australia is opposite. What does it tell you, in terms of certifiability of this class? What Australia shows is it took time for surcharging to take hold -- years. And so let's say that would be the case here, that parity surcharging would spread. They would be pioneers. More and more merchants would do it.

What that shows, especially when you juxtapose that against the fact that you have some states that band the practice and some states that don't, the circumstance you don't have in Australia, is that over time some merchants are going to benefit -- again, assuming there's value in this, which we don't -- and others won't. In fact, it's even worse than that. Let me pose a hypothetical.

You've got a gas station on the border of Texas, Texas and Arkansas, and another gas station across the street in Arkansas. One state bands surcharges, the other state does not. So the merchants in Arkansas engage in parity surcharging, and it's as beneficial as Mr. Friedman said. It

will benefit at the direct expense of its competitor across the border. That is the essence of a situation where you have a class -- where you have a supposed class relief that benefit some to the detriment of others. That can't possibly be a cohesive class, especially in a mandatory context, whereas the Supreme Court said the relief must be indivisible and provide relief to the entire class at once.

And so Australia actually refutes the certifiability, sorry, your Honor, of the (b)(2) class.

THE COURT: Let me ask you about this. If you go to a gas station now -- let's bring it down to its simplest basic set of facts. You go to a gas station and there are two prices for a gallon of gas. One is the cash price and the other is the credit card price. All right?

And is there any reason to believe that people -- that customers, consumers are reluctant to use a credit card because they can pay 10 cents less at the cash price than at the credit card price? That's a surcharge right there. Is there any evidence to indicate that consumers try to find a place where there's no difference between cash and credit card?

MR. SHINDER: I don't have any evidence of that, your Honor. It may well be that consumers want their rewards, so they're perfectly comfortable, you know, with paying, you know, with a credit card in that situation. I don't have any

evidence of that, but --

THE COURT: That goes to the question of whether consumers are worried about a surcharge.

MR. SHINDER: Well, that's -- that scenario is a discount as opposed to a scenario where they're facing a surcharge, which --

THE COURT: Well, it is a surcharge.

MR. SHINDER: It's a more forceful form of steering, so it doesn't necessarily --

THE COURT: Why is that a discount as opposed to a surcharge?

MR. SHINDER: What I understand your hypothetical to be, it's a gas station and it says, I'll discount if you pay with cash --

THE COURT: No. No. It says, this is the cash price, which is the basic price. But if you care to use a credit card, there is an additional charge of 10, 15 cents per gallon of gasoline.

MR. SHINDER: Well, the way that plays out in the real world, is it's used as a discount for cash. And so consumers see that, I get a discount if I pay with cash, at one price and it has a lower price.

THE COURT: It's interesting you see it that way.

MR. SHINDER: So they're not posted it as a surcharge.

THE COURT: Go ahead.

MR. SHINDER: So let me address some of the substantive fairness issues in the time I have left. This really is very simple. Professor Hemphill nailed it. We concluded that, quote, there is a substantial probability that the proposed settlement's effect will be small or zero. That's at page 42 of his report. His bottom-line conclusion leaves no doubt, no doubt that the proposed deal will provide little or no value for several reasons, including the following: That few merchants, if any, with parity surcharge, due to state restrictions -- and I will note, as Mr. Canter did, that one of those restrictions was just upheld in Florida; fewer customer defections and technical impediments;

Two, that unlike brand surcharging, parity surcharging, quote/unquote, lacks the tools to generate inter-brand competition and class parity surcharging almost certainly would not inject any price competition or result in price reductions for merchants;

And three, the differential surcharging by contrast introduces a, quote/unquote, clear mechanism by which meaningful price competition and price reduction for merchants can resolve. And all of the experts, your Honor, that have commented on this settlement agree with that conclusion. Let me repeat that. All of the experts before you agree, including plaintiffs' expert, Dr. Frankel, that differential

or brand surcharging would be highly pro-competitive and, yet, the proposed settlement would bar that practice potentially forever.

How can such an anticompetitive outcome be the proper resolution of an antitrust case? Your Honor, we submit that the answer to that is self-evident.

Now, plaintiffs' response to Professor Hemphill's dispositive conclusions includes a lot of smoke and mirrors about parity versus differential surcharging in Australia and talk about different reports from Australia. I will leave the response to that to others.

But when it came to Professor Hemphill's emphatic conclusion that there is, quote, little demonstrated merchant appetite for parity surcharging in the United States, plaintiffs are tellingly silent, other than saying, We should look at Australia again. Last I checked, the geographic market in this case is the U.S., not Australia. This case is about competition here. And if anything, Professor Hemphill's conclusions regarding U.S. merchants' lack of appetite to engage in parity surcharging were understated.

You have before you today an awful lot of the top merchants in this country, from Wal-Mart to Amazon to Starbucks to 7-Eleven to Target to Macy's, I can go on and on, to Home Depot, not to mention pretty much the entire supermarket and drugstore industry. Beyond Wal-Mart and

Amazon, our group alone includes leading merchants from literally every merchant sector and trade associations like RILA, NACS, and the NJA, that represent thousands of merchants. These merchants are vigorous competitors and they disagree on almost everything. But today they stand before you united in opposition to this deal, saying the same thing -- that parity surcharging is of little or no value to them and they want out.

This Grinnell factor, the most important factor in that analysis should easily end the fairness inquiry. Your Honor, in highlighting the universal opposition to the settlement amongst the merchants that have come forward to address this settlement, not one merchant has come forward to support it, other than the proposed class reps. I cannot help but note how unreasonable it is to even suggest that a mandatory class should extinguish their claims on the recommendation of proposed class reps who have barely litigated the issues.

As Professor Hemphill put it, quote, the plaintiffs' anti-steering case is still at an early stage and lacks a well developed presentation of the merits, closed quote.

At the risk of some understatement, your Honor, allowing the views of proposed class representatives who have not developed a case, who know knowing about the objectors' businesses, to trump the considered objections of

sophisticated merchants, who should presume to know what is in their best interest, cannot be justified.

Before concluding on the fairness issue I would like to address American Express' repeated invitation in this reply to the Hemphill report that the Court defer its evaluation of parity surcharging until the DOJ market definition questions are resolved. If anything, American Express' insistent request is a powerful admission that the plaintiffs today have failed to discharge their burden of showing the fairness of the settlement based on the record that is before your Honor.

After all, what American Express is really saying is that even though a lot of them -- the largest merchants in the country have come forward to say that parity surcharging is of no value and even though the independent expert, after reviewing plaintiffs' evidence and arguments, found that parity surcharging is likely of little or no value, the evidence in another proceeding, that's not here today, should somehow trump those conclusions and those objections.

That should be rejected out of hand, your Honor. It would be patently unfair to allow plaintiffs, after they failed to discharge their burden today, to supplement their showing with evidence from another proceeding, evidence that the objectors have had no ability to challenge or respond to. That unfairness is magnified by the fact that that improper supplemental showing would be in service of a mandatory class

settlement that purports to extinguish their claims.

Lastly, even if it were proper to do what American Express request, the evidence in the DOJ case, which was not directed at parity surcharging or the question of whether such surcharging would be negated by customer defections, is highly unlikely to cast a meaningful new light on the settlements' lack of value.

Before I conclude, I'd like to make a few points about the DOJ case, since its relationship to this inquiry has been raised.

First and foremost, no matter what happens in the DOJ case, this settlement should be rejected. We say that for two main reasons: First, the predicate question your Honor has to address is whether the mandatory -- the proposed mandatory settlement class can be certified. And we submit that it should not be certified. That inquiry is entirely independent of the DOJ case;

Second, even if the DOJ were to lose, and let me be clear, we think it should win, but even if the DOJ --

THE COURT: Mr. Hammer is happy to hear endorsement of his position. Go ahead.

MR. SHINDER: Even if we were to lose, that result would have little or no bearing on the key questions that go to fairness here, this parity surcharging having a meaningful value, the DOJ has litigated that. And can a settlement that

jettisons strong merchant claims against differential, the rules that bar differential surcharging while inshrining an impermissible forward looking release cannot be justified. The DOJ didn't address those questions either.

The second broad point I want to make, is that if the DOJ wins, this settlement must be rejected -- period; full stop. As your Honor is well aware, after seven weeks of trial, the DOJ case is about stimulating, for the first time, true inter-brand or network competition by giving the merchants the ability to engage in differential or brand steering.

Even plaintiffs' expert, as I said before, readily conceives that differential steering is much more likely than parity surcharging to give merchants what they really want -- the ability to play the networks off against each other to get price concessions and inject some real competition into this marketplace, like they do with vendors and suppliers in every other industry every day. Against that backdrop it is pretty clear, that if the DOJ wins, it will become immediately apparent that the relief in this settlement would be entirely superfluous. Because of the DOJ, merchants would have the valuable steering tools that they want, and parity surcharging would be, at best, a useless dead letter and, at worst, confusing, because some merchants might have a hard time understanding why they can differentiate via discounting and

soft steering but not via surcharge.

THE COURT: But even if the -- if the Department of Justice is successful, one can assume that the process of appeal is going to go on for many years, it could even end up to the Supreme Court. And in the meantime if the settlement agreement is turned down, the merchants won't have the benefit of being able to surcharge during that entire period. So they're not going to get the benefit of the settlement, to the extent there is a benefit, even if the DOJ wins their case. It's going to be a long time and coming. There's going to be years and years and years, I assume, based on how fast the litigation process operates at the appellate level. There are 7,000 pages of transcript in the government case and 1,000 -- more than 1,000 exhibits, and the issues are very complicated.

What harm is done by allowing the parity surcharging as long as that's going on?

MR. SHINDER: The harm is done. I'm going to assume your question presupposes approve the settlement, parity surcharging.

THE COURT: Just as for the sake of argument.

MR. SHINDER: And for the sake of the harm that is done, it's locking in, through a court approved settlement, an anticompetitive construct and approving a release that reaches forward and permissibly that is worst than getting nothing. And so that would be affirmatively harmful.

But getting back to the point I was making. I'll take your point, that there is an appeal. There may or may not be a stay pending appeal, but what I'm trying to do is focus your Honor on the two -- the results of the DOJ case highlights it. If they win and they survive appeal, assuming there is a stay pending appeal, and they give merchants the ability to differentiate in different ways by steering, parity surcharging is useless. It just highlights once more how little value there is in the settlement. That's the point I'm trying to make.

THE COURT: Do you think that the court's choice as to whether debit is in the relevant market for antitrust purposes, in the Justice Department case, has any bearing on what's done here?

MR. SHINDER: It doesn't, your Honor, actually for the reasons that Professor Hemphill -- he talked about this in his report, that market definition does not dispositive that. The granular question is whether customer defection is -- whether the lack -- the low level of substitutability between credit and debit in most venues would apply an amount of customer defection, such that most merchants wouldn't engage in parity surcharging. While substitutability between credit and debit is obviously embedded in the market definite inquiry, if you were to find that the market is a broad one, American Express postulates, which, if you want my opinion,

would be a mistake. But let's say you were to find them. That would not be dispositive of the question that matters here, which is -- and as Professor Hemphill laid out, it doesn't take much in the way of customer defection to render parity surcharging unprofitable. You know, there is some overlap but it's a distinct question.

THE COURT: All right.

MR. SHINDER: I'm out of time but I do have --

THE COURT: Is anything else briefly that you want to add?

MR. SHINDER: Well, I'd like to, if I may, just comment on a slide that Mr. Friedman talked about.

So, your Honor, I talked at length about what American Express is really afraid of and what matters is differentiation at the point of sale via surcharging. This settlement is all about protecting them from that. So assuming AmEx would allow this. Well, here's why:

First of all, a few things to say about this. This scenario preserves the parity regime and lack of differentiation at the point of sale. What Mr. Friedman is saying, Well, even though there cannot be differentiation at the point of sale, the competition that matters to American Express, Discover can do this, you know, in terms of its communication with cardholders. This goes on everyday already in the current world. This is the equivalent of an award. So

it's --

THE COURT: This is the slide -- just for the sake of the record, this slide doesn't have a number. So this is the slide that displays only the Discover logo and it says: *Your credit card surcharges are on us. Surcharges will show up on receipt but never on your monthly bill.* And this has only the Discover logo and not the merchant's logo on it.

MR. SHINDER: Yes.

THE COURT: As opposed to the other slide which had two logos on it?

MR. SHINDER: Yes.

THE COURT: Go ahead.

MR. SHINDER: So what I'm trying to convey is this competition, Mr. Friedman has a Rico moment. Yes, this is going to happen. This happens already. Discover is free to advertise and no one restrains them from doing this. The consumer, you know, use your Discover card at a gas station over the summer and I will -- you know, we will spruce up your cash back. We'll give you 5 percent instead of 2 percent.

I know a little bit about Discover because I represented them for years. They're free to do this today. There's nothing about this that introduces any competition that doesn't happen today.

The other point is this kind of promotion would only make sense if parity surcharging were to take hold. A

predicate to this is there's lots of parity surcharges such that Discover can say, you know what, instead of saying to customers over the summer, where the gas bill spikes, we'll add some cash back, we'll do this instead.

Again, knowing something about Discover, the only way that they're even going to consider that is if there's lots of parity surcharging, and for all the reasons that I've said and what Professor Hemphill said, it's not going to happen. It's not going to happen.

THE COURT: All right, thank you very much.

MR. SHINDER: Thank you.

THE COURT: Okay. And finally this morning we'll hear from Mr. Arnold. Welcome back, Mr. Arnold.

MR. ARNOLD: Thank you. But before we start my clock, your Honor, I have a question I would like to answer, but it's not my area. I'm going to be pushed for time any way, and I've -- as an opponent of the chess clock in a trial, I shouldn't be doing this. The question you asked Mr. Shinder --

THE COURT: Oh, I'm going to start the clock.

MR. ARNOLD: Well, I was hoping I could hold on to these documents.

THE COURT: And if you have more to say, we can save it until after lunch. If I stop the clock, I'm going to have 20 lawyers asking me to stop the clock. I know how that

works. It's sort of a creeping insidious process.

MR. ARNOLD: Real quickly. The question you asked Mr. Shinder about whether -- would there be some relief from the American Express settlement while the Government appeal goes, whichever way its going. You heard Mr. Friedman say there's going to be an appeal from this also. American Express has not committed itself to change a thing until all of these appeals are run; every one of them are run. So they're going to be running a parallel course. There's not going to be any relief coming out of this, and that's it. That's my answer and I will now go to what I was delegated to come up here and talk about.

Your Honor, I have some exhibits. May I pass these up?

THE COURT: Are you going to put them up on the screen?

MR. ARNOLD: Yes, we are. But I may not be -- I hate doing this, but I've got a lot of evidence, so I want to try to have this here. If I don't get through all of them, you have them in front of you.

THE COURT: Is that on?

MR. ARNOLD: Okay, there it is, your Honor. Thank you.

THE COURT: There you go.

MR. ARNOLD: Now, in starting this, my -- what I

wanted to do is get up here and talk a little bit about this settlement versus the underlying merits of a powerful antitrust case. But before I start, there's something that I'd like to talk about, and that is, that the Visa-MasterCard case, throughout that case and particularly during the really contentious mediation and approval process, Judge Gleeson regularly reminded everybody participating, including people that weren't happy with the settlement, that this was an antitrust case -- no more and no less. That he couldn't do more nor could the class be asked to do more than the antitrust laws would permit.

Most of the objectors -- and it was a lot of publicity to the objections there. And it had a lot to do -- not with the number, because the number is strong here. And you haven't heard a lot of publicity here. The reason was, there was some lobbying efforts in congress, they were trying to get evidence up there. They admitted it in the fairness hearing, that that's what they were doing. So there was a lot of publicity, a lot of news releases and stuff about our position, you aren't reading here. But our position here is more united, more clear, and more focused on exactly what the problem is.

Now, the objectors in the Visa-MasterCard case were wanting more. They wanted basically rate regulation. They wanted the interchange fees to be -- in some way for

Judge Gleeson to interfere with the setting of those rates. And Judge Gleeson kept reminding us, this is a market solution and that's all we can get done here.

Now, he also pointed out that some market solution, that he could deal with only Visa and MasterCard. And he pointed out that there was an American Express problem. And I think I'll get this right on the first one.

And he said in his order, there was an American Express problem. And he reminded all of the litigants, and of course we were there supporting the class settlement, the lawyers and the clients that are in front of you, the individual merchants case were supporting that settlement. And we were supporting that settlement because it did take all it could do to unleash the market forces of horizontal price competition for network services. That's what that was.

Now, the objectors here are united because this is an antitrust case -- no more, no less. The class here is attempting to get a relief and give a pass to American Express going forward for less than what the antitrust laws require. This case was brought to introduce horizontal price competition into this marketplace where it's clearly absent. This settlement, and we're all united in it, does not do that. In fact, it could be worst than that.

Now, what the worst part of it is, that if -- and as Judge Gleeson said, that if American Express is the only

remaining major network, its insulated price competition will assist in the efforts to fix it.

Now, Mr. Friedman suggesting that that American Express problem that he was talking about being fixed by this settlement is inaccurate. It's not correct. It does not introduce any horizontal price competition. It actually interferes with it. Because parity surcharging does not allow for any merchant to award any lower rates.

So you're actually going to encourage an escalation of rates. Because American Express can keep raising their rate and say, Well, I can't be surcharged any more than Visa and MasterCard, so I can keep pricing it up. It actually has a reverse effect.

THE COURT: Well, let me just point out that there are limits on what the plaintiff class representatives could do in this case that didn't exist.

MR. ARNOLD: There's no question.

THE COURT: No, no. When the Visa-MasterCard case was being resolved, and that is basically -- these class representatives have been to the Supreme Court three times in Italian Colors. So, you know, now there are more limited options. Right?

MR. ARNOLD: Well, no, there's more limited options for them to litigate in the Federal Court but that certainly tells you why they should not be allowed to come to Federal

Court and try to give away everyone else's rights, including my client's rights, who are here in court, who do not have limited options. Who are -- who are prepared and have a fully discovered case and prepared to move ahead, hopefully not long after the Government's case.

But, your Honor, the biggest problem with this is that if you approve this settlement, after seven hard years of litigation in the Visa-MasterCard case, you would have basically helped them take away the -- what was fought for in the Visa-MasterCard case. Because as Judge Gleeson pointed out, he could only affect the Visa-MasterCard activity. This case is designed -- our case is designed to take and others who want to litigate with them.

Our clients, by the way, are here in court. We're not looking for an arbitration discussion or anything else, because we're here. But this settlement would take away our ability and all the other merchants in the country ability to utilize the ability -- I mean the Visa-MasterCard settlement. And Professor Hemphill noted that in his report. And Professor Hemphill got this report right.

There's a couple of questions that he asked in there. But given the record he had and given the fact that we've lived with this case for all of these years, we were all terribly impressed with the way he was able to understand this stuff, as we go through.

THE COURT: May I ask a historical question?

MR. ARNOLD: Yes.

THE COURT: Why is it that this -- this case was not part of that case or that it was not added to that case? Because I would have been delighted to share or to provide this case to Judge Gleeson.

MR. ARNOLD: Your Honor, as you well know, the Eastern District of New York has the rule that related cases goes to the judge to decide whether it's related or not. We filed our case, said it was related. Judge Gleeson declined it. I think it was a gift to you, a Christmas gift.

THE COURT: He's done that to me before.

MR. ARNOLD: He did it this time, your Honor, because he had the opportunity. But I honestly think, having put in his ten years -- eight or nine years in the Wal-Mart case and the six or seven more here, I think at the moment when he turned it down, we were in the middle of that case, he had not emersed himself in the details. I think if we had filed the case right during that mediation, I believe he would have taken it, because by then he understood that this was a three-prong problem.

THE COURT: I was just curious. I'm delighted to be here with you.

MR. ARNOLD: We gave him all the chances in the world to help you out, but unfortunately --

THE COURT: I tried several times to help me out but nobody agreed with that. Go ahead.

MR. ARNOLD: I want to back up just one moment, because a lot of this conversation, and sometimes when you were asking questions trying to parse what's going on here with what people's positions are and, for example, when Mr. Shinder was saying that what you thought was a surcharge, he said was a discount.

THE COURT: Well, we have a disagreement about that.

MR. ARNOLD: Here is the point, you don't have to disagree.

THE COURT: Because we never had a surcharge until a certain point when, as I understand it, there was an added charge to the -- to the station owner for accepting credit payment, credit card payment. And I don't know how that came about, but that's how it was explained to me at the point of sale on one occasion.

MR. ARNOLD: But here's my point.

THE COURT: Go ahead. That's not evidence in this case. I'm just asking the question.

MR. ARNOLD: No, no. But the point, what is evidence in this case is that every economist agrees that a price is a price. Surcharging and discounting are just prices. What -- what's happened here, when Visa and the banks years and years ago were fighting this, just like American

Express is fighting it now, they were able to get legislation in some of these states to put a pejorative label on surcharging.

And the truth is -- you have a background in the airline industry -- the airline industry has unfolded this, it's called -- any modern economist will tell you, those are antiquated terms -- it is called unbundled pricing. That is attributing the price to the cost generator. That's how you do it, and it's called unbundled pricing. And that's why in New York Judge Wyckoff found the statute unconstitutional, because it was -- it was stopping the communication, it wasn't stopping surcharging. It was simply saying, you can't call it surcharging.

The example is -- you hit on it yourself, at the gas price. The example is, the price is a dollar. If you use the card I want you to, it's 98 cents. That's a discount. The price is 98 cents. You use the cards I don't want you to use, it's a $1. That's a surcharge. That's an absurdity in economic terms.

It's only because it's nomenclature and it helps. I've been wrestling with this for years. Once you get that in your head, this other stuff, you see it's a bunch of arcane rules that are plugged in here, all for the purpose of avoiding by the banks and the networks and American Express, avoiding horizontal price competition between each other. No,

you can't do that. So you can't set a price communication in any direction. And when you step to that, then this case becomes much simpler, and it's simple for this simple reason.

The American Express rule clearly restrains inter-brand price competition, and everybody agrees on that. Everyone agrees on that, including American Express. And they -- they have a defense. Now, I'm not raising by their defense, and I'll talk about that in a minute. But this is -- this is Mr. Funda, his trial testimony here. He says, and this, your Honor, if I wanted to title it differently, I would say that this is a confession of a monopolist, that's what it should be subtitled. Because what he says here is, when asked if -- if American Express ever tries to lower its price to compete for business, and he basically says, I don't think anybody's business strategy is to be cheaper than the next guy.

Well, he should be in other businesses because a merchant, every client in this place and objecting to this, their object is to control their cost and be cheaper than their competitor.

Now, if you provide some quality, then people may pay the extra price, but they choose to insulate themselves from price competition with these rules. And so in the end he says, no, we don't compete on cost. Basically he's saying the reason they don't compete on cost is because they have these

rules that doesn't require them to compete on cost.

Every merchant in America would sign up for a rule like that, if they could get them. The problem is, they can't. They've been able to embed this thing into a process that evolved over the advancement of economics and law coming together that this thing is now seen as being illegal. They got away with this for years. The law used to count up market sharing percentages instead of looking at the direct group of market power, which you recognized in your summary judgment opinion in the Department of Justice.

Now, I want to keep moving. What I want to point out here is that everyone, the experts, American Express' experts in the DOJ case, Professor Gilbert; the expert in our case, Professor Ordover; Professor Stiglitz, our expert; Dr. Frankel, the class's expert; Dr. Katz, the expert for the Department of Justice, they all agree that this restrains inter-brand competition, as does American Express. And this is the one that's most important to me.

I'm going to skip ahead here. And that is that Discover and MasterCard agree that it restrains, and so does Visa. Visa recognizes and they've changed their rules.

And so in the class case they all recognize that it restrains horizontal price competition, and they walked away from it. Only American Express, still on the wrong side of history, is hanging on to this thing. And what we are

suggesting is that if you look at the Discover testimony -- now, I've been doing antitrust litigation for over 40 years, and I've never seen a better competitor testimony than the testimony presented right here in your courtroom, in which Discover -- there's no hypotheticals here. Mr. Friedman is talking about hypotheticals. There's no hypotheticals here. This is a company that launched the very product that we're saying would come into play in this nation, if these rules were removed, and they couldn't get any traction with that product because of these rules. They eventually just raised their price and became one with a club, and he basically told you here that their business model, they would return to it if this rule was removed. And what they did, that starts the downward spiral, it introduces the horizontal price competition. So there's no hypotheticals here.

You have in your courtroom under oath the man who has the company that launched the very product that all these merchants are here saying that we'll change -- we'll change the surface here of competition in this country if American Express' rules are removed.

Now --

THE COURT: The settlement. We're going to talk about the settlement too.

MR. ARNOLD: I am going to talk about the settlement. But remember -- I should have put on my -- I

should have had a T-shirt on that said Grinnell IV. I'm up here on the fourth element, and that is the strength of the case. That is the strength of the case that's being given away here in this -- we're virtually zero. This is a case that has tremendous power and traction and is being basically the injunctive relief and the ability to do something about this and interject this competition is being basically given away.

The truth is, your Honor, I don't know how we are here. This settlement gives away way, way too much for a case like this and locks all these merchants into this. But I recognize we have to go through this process and I apologize if I've gotten a little too excited about it. But Professor Stiglitz, who is our professor, but here's a guy who has done a number of major issues for countries and governments and everyone else. He basically says here that, that various entry are created, you're not going to get any new competition. As you were asking earlier, would a group of investors come into this? The answer is no, they will not come in as long as they cannot differentiate themselves in some way.

Discover is the last entry. And the reason Discover is the last entry is because they got in and found out they could get no traction, because these rules stand in the way. If these rules are changed in an appropriate way, differential

surcharging, unbundle pricing, forget surcharging, discounting, if unbundled pricing is permitted -- and by the way, if -- if we win our case, if the Department of Justice wins theirs, they'll get part of it. If we win our case, they'll get it all. And that means the watch word will be differential pricing. And you won't be wondering whether it's a surcharge or discounting.

Now, quickly, and the whole argument here about the fact that this is what would happen, and all due respect to Mr. Friedman, I'm not in any way belittling anything that he's done. But he puts that example up there about the Discover card. Your Honor, Mr. Shinder is right, you can do that today. That's not -- that's not at the point of sale. That's not -- that's not communicating the price directly, and so it supplies no additional value at all. But the whole point is that the marketplace should decide all of this and the marketplace -- once again, when I was trying to back you away from how do you surcharge, how do you do this, these merchants already have all types of different plans. For example, the grocery store, Kroger, or any particular --

THE COURT: A&P.

MR. ARNOLD: A&P, if they -- if they choose, they have rewards programs, they give you extra things if you buy there and everything. If you are free to price unbundle, then they are free to say, all right, if you have -- if you get gas

points here, if you do this, we'll give you double gas points if you use a Discover card, because they give us a cheaper price. We give you no gas points if you use an American Express, because it's too expensive for us. No one gets offended over that, it communicates the -- is that a discount or a surcharge? That's why you don't need to dance on the head of that needle. Basically it's an unbundled price and that's why all the central market planners that everybody volunteered, all the critics are saying, well, merchants won't do this, merchants won't do that. The truth is, if you stop interfering with horizontal price competition, if you stop interfering with that, merchants will figure it out and they won't be dumb enough to walk out and say, Hey, give me 2 percent. They don't want to offend anybody. What they will do is come up with creative ways to use all of their marketing tools to encourage the use of certain cards, discourage the use of others. And as we know, if you do that the prices will come down, including American Express' price.

Now, your Honor, and I -- and this is when I was talking about the strength of the case. Your Honor basically has ruled in the Department of Justice case, that if, if plaintiffs can prove an actual effect on competition, there's no requirement to prove more than that, to prove the first part of this case. And I submit, American Express, and virtually everyone has admitted that's proven. The issue here

is American Express has put out what I call a bogus defense, it really is.

Now, since I crossed the Brooklyn bridge I snapped a photograph of this, just so I could make this point.

The United State Supreme Court has made it clear as it can possibly be that you cannot defend, cannot defend an anticompetitive practice by saying it's not reasonable for people to compete. And of course the similar case on that is the National Society of Professional Engineers. And the reason I put the Brooklyn Bridge up there is because that was about bridge building.

They offered up that they had to fix prices on engineering services because bridges would fall. Things would happen terribly. And the Supreme Court says, that's for other areas. It's not for the law of competition. You cannot justify highjacking the law of competition for some good purpose. And what American Express really is telling you is, they've said it here, they've said it in our case, they say if we -- if we are forced to compete, horrible things could happen. We could be off -- we cannot be in here giving Visa and MasterCard their -- the competition that we give now. It could be a terrible thing to happen.

Well, the fact is the market decides that. And if, you know, if the Supreme Court says that the Brooklyn Bridge or any other bridge in America could collapse because of price

competition, but that's not the antitrust law's concern, it's for other things, they certainly aren't going to worry about the fact that American Express doesn't like the way it affects their business model.

And so their defense is simply it's an insufficient defense and they have attempted to hide it in what I call the two-sided market fallacy. They have attempted to say that because it's a two-sided market you can't measure this anticompetitive horizontal price fixing thing that they've put together here, this inhibiter of price competition which they can't avoid so they have to admit it, so they came up with something else. They came up with the same thing that Visa and MasterCard offered up until they gave up. And that is that you look at the issuing side and you look at the other side, the network side, and you put them together and you look at that effect, and it all sounds nice. There's just two problems with it: One, no court has ever accepted that as a measure of the way you do it, and you will never find one that will.

Secondly, this is just an economic theory, but more importantly, your Honor, they don't do it. They do not do it. Their testimony, and I've put this up, Ms. Langwith, who is the vice-president for pricing of merchant services in America. And her definition in our case, basically in the classes case, she gave the testimony that this is significant,

In the pricing group, do you receive any data from the cost of American Express' loyalty program?

She says, *No, that would not be something that we would typically see or have data on. I mean, those are costs that are part of the issuer's side of American Express. So we don't -- they don't usually look at our costs, and we don't usually look at their costs.*

They can tell you about two-sided markets but they don't operate their business that way. They do not do it. And the question was, *Are those costs relative to how you set your prices to merchants?*

We don't really set our prices to merchants based on cost. So -- we set our price based on the value that we deliver to merchants, by industry, by merchant size. So the cost is not a factor in that.

Once again, a confession of the monopolist, they didn't have to pay attention to the cost, but more importantly a confession that the two-sided market theory is a fallacy. Not only does the law recognize it, but American Express doesn't do it, your Honor. And Discover's president, again, he's talking about basically the same stuff, about whether there's a two-sided market operation here. Is there -- do the rewards cause them to do that. And the answer is no. There's no problem with being able to do this. If they compete, they can still do it because they make money on that side of the

marketplace.

I'll get now to the settlement itself.

THE COURT: How much time do you have?

MR. ARNOLD: Well, actually you started the clock, the two questions, I don't -- see, I told you wanted to keep that chest clock myself.

THE COURT: Go ahead and let's see how far you go.

MR. ARNOLD: As you know, obviously everyone is reminding you of what Professor Hemphill said, that the probability is effectively small or zero, and he's talking about the parity surcharging. He also said that he can't see how there's a mechanism to lower prices using parity surcharging. And he's 100 percent correct on that. That's why every major network in America is saying don't do this. By the way, you had a couple of people here talking about surcharging.

We're not -- we brought this case and fought to get that very right and that's what we're here to do. But it's not the right to charge 2 percent, it is the right to unbundle pricing, and that's what we're here fighting for and that's what we're trying to get done. And as Professor Hemphill says, there is a mechanism in that to get the price done.

Now, this is -- he got this -- this is a very interesting thing. He says that this actually creates the interest we're talking about, where a group of investors are

going to come in and start a credit card company. The court's expert says that won't happen because -- with this relief -- because parity surcharge preserves the inability to reward new or lower priced networks.

So if you can't come in and get market shares, there's no reason to investment your money. This time American Express docked, instead of investing somewhere else. And that's basically why you're not going to get entry and the antitrust laws want to encourage that.

Now --

THE COURT: Want to encourage what?

MR. ARNOLD: To encourage entry, encourage price competition, and lower -- and if there's -- the way you hold people who say that they have value in their product and therefore people will pay more for it. The way you hold them accountable is hold them to horizontal price competition. And if, in fact, they're right, then their market share will say it's exactly as they were. If they are, in fact, incorrect, they'll lose market share and the market decides that, no central planners of any type have to give you a set of rules about how that's going to work. The market will decide that.

Now, I want to try to skip ahead in just a moment. Here, I'll be the -- I guess Mr. Friedman and I agreed on this completely. American Express is a good laboratory for looking at this case, for the part you're being asked to look at. And

American Express agrees with this too. And the reason I say American Express agrees with us, is we have the documents American Express.

Now, I'm not putting their documents up on the screen, your Honor, because they're under protective order, they're in your folder but I'm going to refer to a couple of them in general terms. I'm not going to put them up for general publication. But the fact is that when American Express's attorneys were trying to talk to the Department of Justice from bringing the law suit, they basically said American Express's experience in Australia, confirms that a significant number of card members who are exposed to differential surcharging shift their purchases to other payment method. The documents that we have here reference to them. Every one of them shows you that in their planning for the United States of America, not Australia, they're planning here, they relied upon, studied, and analyzed the appearance in Australia and they concluded there that differential surcharging was a risk.

They basically, if you read those reports closely, you'll see that they say their plan is not to treat parity surcharges any different than companies that don't surcharge. It's the differential surgeries that they're trying to stop. Because they recognize parity surcharging they can get away with it, because they can keep going up, claim they got better

value, and they can keep raising the price. There's no pressure to put it back down.

Now, the other documents that I didn't want to put up, but I put it in your folder, have to do with the fact that American Express knows parity surcharging has no effect. Those documents, look at the notes in there. They're not afraid of parity surcharging. They would agree to this, I believe, that this is a -- this is a classic brown pass here. You know, throw me in here and make me have to do parity surcharging. I swear I don't want that to happen, yet their only internal document say they don't really care.

So this victim session, they're talking about how they've made this adjustment in their business plan. This is it called -- this is a qualified slight retreat that actually is through the excellent lawyers, no one ever accused them of not having great lawyers -- and they do have them sitting right there. And they have come up with a clever strategy to actually -- that's right, they are -- clever strategy to actually make -- take what is an impending defeat.

Because this -- they will never -- this two-market fallacy will never -- I don't think it'll withstand this scrutiny, part of it will not withstand the scrutiny of the Second Circuit. So they virtually admitted that they have rules that interfere with horizontal price competition that they got this excuse that they basically call it the two-sided

market. No court is going to let them get away with that. So this is an attempt to try to pull this thing -- basically, pull it out of the hat.

Now, I want this one quick moment because I'm actually going to finish, I think. Now, American Express has offered up the other thing, this horrible thing that could happen, what I would call a highly dramatic presentation that they would go out of business if this thing -- if you actually rule against them, that they would be threatened.

THE COURT: We're back on the Government's case now?

MR. ARNOLD: But it's part of the record here, your Honor, that's what we're looking at.

THE COURT: Okay. I just want to make sure what we're talking about here.

MR. ARNOLD: Okay.

THE COURT: We're not talking about the settlement, we're talking about the --

MR. ARNOLD: That's right.

THE COURT: -- MDPs. The settlement has nothing to do with the MDP.

MR. ARNOLD: Well, the settlement doesn't the way it's set up, that's just the way it's structured.

THE COURT: Okay, go ahead.

MR. ARNOLD: But my point is that's why they would agree to something like this, so that they can avoid being in

jeopardy for those things that they are attempting to underscore their entire defense of this two-sided market by saying something horrible is going to happen to American Express if it doesn't happen. It didn't happen.

Well, you know, Mr. Chenault is one of the top executives in America, and he's looking after his company the way he felt he should, and he's being paid to do. But when he's talking to investors, you Honor, he never once ever suggested -- in fact, he says the experience in Australia is they're doing great. Both parts are doing great, not just the part he's suggesting here, about the bank, their proprietary business is doing great and their financial statements look like they are doing great, and it sounds like he's being accurate, in not being dramatic with them and maybe a little more dramatic here.

The last part of this was that in our case Professor Stiglitz was asked, you realize American Express could go out of business if, in fact, differential surcharge becomes part of this? And he was asked, do you think that would be a good idea, less competition?

And they asked him three times. He kept qualifying it by saying he thought the best thing to do was for American Express to change their rules and become a viable competitor here and help introduce price competition in the case. But after being pressed three or four times, he basically said

that the choice -- if the choice is between American Express remaining in business with -- with that rule in place, which prevents all other price -- horizontal price competition from being removed, that the price competition would be better, because they're the only reason this competition is not taking place today.

Now, having -- so I will end on a way that gives -- that fits what I was supposed -- I kind of got excited about the merits of the case, your Honor, and I apologize for that. But this one little isolated part --

THE COURT: You couldn't say a word for seven weeks. I'm sure that was difficult.

MR. ARNOLD: It was difficult. I asked Todd for time two or three times back there.

THE COURT: I'm sure.

MR. ARNOLD: Is that American Express has created in this very document, not only do they never have to commit to changing these rules until all the appeals are run, but secondly, they have an escape clause in here that they agree not to terminate merchants solely for surcharges, but they didn't commit not to terminate them for surcharging as one of a group of causes. And the simple thing in having watched what they did in Australia, a simple scenario is this: They simply told merchants that aren't growing market share and they said, you know, you are on a list now that can't -- that

just -- you're marginal, whether we're going to keep you or not, you're not market share. By the way, you all happen to be the people that are surcharging. We're going to exercise our rights and not do business with you and terminate you. And because they could establish, real easy records to establish, you could selectively send out messages like that, is not solely for surcharging and they could terminate them.

THE COURT: How does that square with the presentation that American Express made in the Government's case that -- that they are at a competitive disadvantage with Visa and MasterCard and the proof of that is that so many fewer merchants accepting American Express cards because of the perception that the discount rate is higher for American Express merchants, some merchants simply will not accept the card because of the higher discount rate.

MR. ARNOLD: That's the classic case we heard in law school, when someone basically murders their parents and then ask for mercy because they're an orphan. They basically -- they basically are saying, our prices are so high that we're at a competitive disadvantage on merchants that don't feel the market power and compunction.

This is a very interesting point. We went through this for a number of years. In both cases, your case and Judge Gleeson's case, and in both cases what happens here is that their market power is directly tied, maintained by their

rules, but they have to get in the door first. And you'll see actually in one of those documents where they went to a small merchant fee appoint -- I can't say that -- a small merchant fee, a very small amount. And then once they got the merchants, they jumped it back up, almost doubled the price.

And of course they didn't lose a lot of those merchants. Because once they get in, and insistence starts inside the thing, then they can't drop it. So the answer is that their claim that -- that they're at a competitive disadvantage is one of their own making, if they are. Because they certainly can get into as many merchants as they want to.

Now, American Express also is taking advantage of another -- of another phenomena of their. And this is all due respect to them, because they know they were very snobby. At one time, when I was a young lawyer, I couldn't get an American Express card. Because they were kind of snobby. You know, you had to really have a good income --

THE COURT: Do you have one now?

MR. ARNOLD: I do. The reason is, they've lowered their standard. They have lowered their standard. They lowered from the merchants that they go to and they lowered it for the people that they allow to get an American Express.

THE COURT: If you keep this up, you'll be getting a cancelation.

MR. ARNOLD: I've been expecting one for years.

But, any way, the answer is, they're not at a competitive disadvantage. They've chosen to position themselves in the market that way. That's what they've done.

THE COURT: Do you think there's -- you started off by mentioning that Judge Gleeson on repeated occasions said that the contours of the Visa-MasterCard case, were that it was an antitrust case.

MR. ARNOLD: That's correct.

THE COURT: All right. Is there any allusion in this case, that it's anything other than an antitrust case?

MR. ARNOLD: No, your Honor, there isn't. And that's why all of the merchants here that opposed it are all united, that this thing doesn't work, and the criticisms are fairly consistent. If you had attended that hearing it was -- it was more of a three-ring circus. People were up with every type of complaint possible, including don't approve this because Congress will never regulate rates if you do, all those types of things.

And Judge Gleeson would continue to repeat, that's not our issue. I can't do that. I'm only here for this. And a lot of fairly influential merchants who -- because they had been involved in the lobbying efforts to Congress to try to get regulation, and they were really seriously believing that might impair their ability to go to Congress and say, look at these rates, you should regulate them.

And that's -- so the answer is, he repeated that because of that issue. That's not the issue here except, as I said earlier, antitrust case -- no more, no less. Unfortunately, this is way less than what the strength of that -- and I'll remind -- my number four here, that is Grinnell, element number four, the strength of the case, this is a powerful case. And, your Honor, I thank you for your patience.

THE COURT: I just have one more question. Does the existence of the Durbin Amendment have any effect or influence on this situation involving the class settlement?

MR. ARNOLD: No, it does not, your Honor. The Durbin Amendment, that's not absolutely correct. Because the Durbin Amendment had some merchants, the smaller merchants, lower their rates. Now for some larger merchants, like most of the people here, their debit rate actually went up, because of the way when it got regulated.

But to the extent it made debit cards something to steer to, that's -- it has some minor impact but it's not debit card steering, that's the critical issue here, it is the steering between these credit card companies. Since you asked that, I was going to -- I was almost going to say something about Mr. Korologous' argument about, that we had based our whole case, our damages on the debit card issue. I started to say something, and Mr. Almon back there said don't get

distracted, get up and talk about what you want to talk about. But the fact is that it was misleading about what he said.

It is true, our expert used debit, as a define to try to figure out what a but for price would be. He wasn't saying that that was -- that that is what -- that the -- that that was the competition. He was saying that's the only -- in this payment system, that's the only competitive price I can find. So I used that and built it backwards and things that are peculiar to credit cards, that's what the price ought to be. Thank you, your Honor.

THE COURT: Thank you.

MR. ARNOLD: I appreciate it.

THE COURT: All right. Why don't we take lunch until 2:30 and then we'll move on with the next speaker. Thank you.

(Luncheon recess.)

(Continued on the next page.)

AFTERNOON SESSION

2:30 P.M.

(In open court.)

THE COURT: All right, before we proceed, let me just mention that one of my new law clerks is a former associate of Cravath, Swaine & Moore, but is in no way involved in dealing with this litigation in chambers. So I just wanted to mention that and put it right on the record.

Okay, the next group is Blue Cross and Blue Shield health insurers, objectors. Mr. Feinberg.

MR. FEINBERG: Thank you, your Honor. Good afternoon. Adam Feinberg on behalf of several dozen Blue Cross and Blue Shield health insurers, and the entities that own them and some of their affiliate entities.

And I thought, your Honor, I would start by explaining just a little bit about who we are. As you may or may not know, Blue Cross and Blue Shield Association licenses out to different health insurers across the country, the right to use the Blue Cross and Blue Shield trademarks. And the clients that I represent are the licensees of those trademarks in almost all of the states across the nation as well as some health insurers that are owned by the same companies that own these Blue Cross entities that also have non-Blue Cross branded business. But Blue Cross in and of itself, Blue Cross branded business covers about one in three Americans. So the

group of health insurers that I represent is an enormous portion of the health insurance business in the United States.

And I think it's fair to say that American Express probably has no idea how the health insurance industry works and I know that the class representative, class representatives have no idea how the health insurance industry works, and that is precisely why they make a very bad set of representatives at least as it relates to negotiating a settlement that would bind health insurers.

So what I would like to do, your Honor, is just explain a little bit about the market in which health insurers operate and particularly with the market that exists starting essentially as of the beginning of this year with the effectiveness of most of the important parts of the Affordable Care Act.

So the Affordable Care Act, amongst other things, created health insurance exchanges, these are electronic marketplaces that you probably are familiar with, on which insurance companies sell and compete for business in the individual and soon to be small market business. There are currently millions of individuals in the United States who purchase health insurance through this market and it's estimated by the federal government that that number will run in the tens of millions in the next few years.

And these healthcare exchanges, these internet-based

healthcare exchanges can be run either by a state, if it elects to do so, or by the federal government if the state doesn't do it itself. And as you may also be familiar with, your Honor, more and more states are opting not to do it themselves and are leaving that job to the federal government.

And when the federal government operates one of these exchanges, they require health insurers to enter into a written agreement and they impose a whole source or a whole set of rules and regulations on such health insurers. And there is one such rule that is particularly important in this case. It expressly outlaws the use of surcharging or even discounting.

I know you and Mr. Arnold were engaging in a back and forth about whether or not there is a difference between those two things, but for our purposes it doesn't matter. Both of them are expressly prohibited by the Department of Health and Human Services when you are selling products on federally run healthcare exchanges.

So for example, one of my clients is Blue Cross and Blue Shield of Louisiana. They operate in a state that has a healthcare exchange run by the federal government. They simply cannot surcharge or discount for that matter. In all of their business sold on the internet-based marketplace that was created by the Affordable Care Act.

In addition to that, the Affordable Care Act creates

rules that are known as the MLR, or medical loss ratio. And these are essentially pricing regulations that say that health insurer must spend, in the individual market at least and in the small business, in the small employer market, must spend 80 percent of all of the revenue they receive with a certain very limited exception on healthcare-related expenses. That's mostly doctors visits, wellness programs and things like that.

The other 20 percent is allowed to go to profit and all of their administrative expenses. And in that category would be the discount rates or discount charges that are charged by American Express and that we're here today to talk about.

And so if you take a discount rate that's whatever it may be for a particular merchant but roughly 2 percent, let's say, that is a huge portion of the 20 percent that a health insurer has to cover all of its administrative expenses and profit. And we put a couple of declarations in the record. The health insurers that I represent are all over the map. Some of them do not meet this threshold. And so if they are charged a discount rate they cannot pass that on to their customers in any way, shape or form. They can't raise their prices, they can't surcharge, because if they do, they end up giving 80 percent of it right back to the consumer via a rebate that is required by the Affordable Care Act if you do not meet the 80 percent MLR threshold. And that MLR group

applies to all of the business, not just the business that is sold on the internet-based exchanges that I talked about previously.

And so while most of the reasons that health insurers have for accepting credit cards relate to the exchanges that are created by the Affordable Care Act. In fact, I think every one of the declarations that we put in notes that these Blue Cross entities firmly believe that simply cannot sell on an internet-based marketplace unless you take credit cards. I think that's sort of an obvious point. But that is where most of their credit card transactions are likely to occur.

But even aside from that fact, aside from that marketplace where the rule says if it's run by the federal government they cannot surcharge, totally aside from that, we have these MLR rules which effectively limit, if not eliminate, the ability of a health insurer to surcharge or view any other mechanism for that matter to pass on the cost discount charges to its customers.

And there is one other element of this regulatory backdrop that I think is important here. And that is the timing. So all of this came into being for calendar year 2014 in terms of these exchanges, and you could enroll as early as October of last year but that was the beginning, that was the first time that any health insurer was selling on the

internet. And for many health insurers, that was the first time they were accepting credit cards. And so we have some examples of insurers who put declarations in the record that say they actually right now take American Express.

But I think it's important to note that a good many of the Blue Cross and Blue Shield health insurers do not take American Express, they are still trying to figure out what the credit card business is all about and whether they want to take credit cards at all; and, if so, which ones do they want to take.

And so some of these companies, while they're very likely to take credit cards in the future, do not take them right now but they would still be covered by the class definition to the extent that it covers merchants who accept American Express in the future.

And I'm not going to get into the due process arguments. I know some of the other objectors are going to get into that, but some of my clients are the classic examples of the so-called future draft picks that you mentioned before. They did not get any notice that this case was going on. They got no notice of the post settlement. They happen to be here now because they heard about it from some of their brother and sister Blue Cross entities across the county who did take American Express and did get the memo. How many other entities out there didn't any such notice and didn't find out

about this otherwise, of course, who knows.

But at the end of the day, the Blue Cross and Blue Shield entities believe that the settlement should be rejected for a whole host of reasons, all -- well, I should say most which relate to the fact that they simply get little, if any benefit out of this settlement.

We completely agree with the objectors that you heard previously that the value of this settlement is extremely low in that parity surcharging isn't going to do any good. But whatever small value that might have had for the average merchant, it's substantially less, if anything, for health insurers, for the reasons I said previously. They simply cannot surcharge if they're selling at least on these internet-based exchanges. And even when they're selling at other marketplaces, they are bound by these MLR rules which prohibit them from -- at least if they're at or above the 80 percent threshold which prohibit them from passing on the cost.

And so they look at the settlement and say I'm getting nothing and they want no part of it. You had asked before, well, wouldn't an entity at least get temporarily some benefit out of parity surcharging while courts of appeals were sorting this all out. Well, in our view, it's not worth the release they have to give. They get so little, if anything, out of it, the deal is simply bad. And it's not as compared

to what they might get in a lawsuit, they're not parties in any pending lawsuit, unlike some of the other objectors, they don't want anything to happen. They just don't want to be bound by the settlement that's being proposed in this case.

And I just give you a complete hypothetical example. But some of the rules that are included in the release in this case relate to the honor all card rules. There's no real relief that's given with respect to that. But hypothetically if the Blue Cross entities cared only about the honor all card rules and didn't care anything about the surcharging rules because they are of no moment to them as they are prohibited by other laws and regulations from surcharging, this case is a disaster for them. They get zero relief in terms of the honor all card rules but they're giving a release that prohibits them from suing both for injunctive relief and for damages on some other element of the rules that American Express has in place in exchange for literally nothing of value. And that simply isn't fair.

And I know some of the objectors in the past had already covered some of the legal bases but we believe that the different situation that health insurers find themselves in means that the typicality and commonality requirements of Rule 23(a)(2) and (3) are simply not met and also that the unity required by Rule 23(b)(2) is not met, and likewise that there's no fair, reasonable and adequate settlement as

required by Rule 23(e)(2).

This is simply a terrible deal for health insurers and they don't want any part of it and they don't believe that it is fair given that there's no value to them in it. Thank you, your Honor.

THE COURT: Thank you. All right, the next objector is Buckeye Institute for Public Policy Solutions.

Mr. Schulman.

MR. SCHULMAN: Good afternoon, your Honor.

THE COURT: Good afternoon.

MR. SCHULMAN: Adam Schulman for the Buckeye Institute for Public Policy Solutions. Some objectors who have previously spoken have addressed the merits of the underlying litigation vis-a-vis the proposed settlement. That's the Grinnell factor for, and that's an objection to the adequacy of the settlement. It's a valid objection but it's only one part of the inquiry that this court's obligated to make. I'd like to put aside for the moment the substantive antitrust merits of the litigation and address where this settlement really falls short in our view. Its failure to comply with many of Rule 23 structural safeguards.

First, the proposed certification. As we've heard from other objectors, the (b)(2) certification is untenable. The settling parties maintain that a (b)(2) certification is proper because of what the settlement obtains, unitary

injunctive relief.

Other objectors dispute the premise that the relief obtained really is actually indivisible. And I think the other objectors have the better of that argument. But importantly, the point I want to make is the entire disagreement is besides the point. Wal-Mart v. Dukes cannot be read to say that any (b)(2) certification goes if the plaintiffs obtain indivisible injunctive relief. Rather, while it is one necessary precondition of a (b)(2) class, it is not the only precondition.

Dukes expressed concerns about preclusion of absent class members' damages claims. The language that Dukes used was by litigation that they had no power to hold themselves apart from; that is to say, the release of the settlement matters. (b)(2) settlements are only allowed to release injunctive claims. Here the settlement extinguishes all damages claims, future damages claims until the release termination date, and even currently existing monetary claims for disgorgement or restitution, that is nonlegal monetary claims.

What is more, if the plaintiffs are correct that all that is necessary is obtaining injunctive relief within the Second Circuit was wrong in Hecht v. United Collection Bureau, a case that postdated Dukes. In that case, that was a Fair Debt Collection Practices Act case where their relief obtained

was in agreement of the defendant not to make violating calls any longer. But the court said you had to look at more than just the relief obtained, you had to look at the settlement class, you had to look at the settlement release itself.

Now, the plaintiffs seek to have this court reimpose exactly what Dukes repudiated, the subjective standard based on whether the named plaintiffs and class counsel think that injunctive relief is important. If Dukes did one thing, it would reject that very standard for (b)(2) certification.

Buckeye's second objection to certification is that the settlement class, as defined, is unascertainable. This is the future draft picks issue in our view, because the class includes all persons who in the future accept AmEx branded cards even if they don't accept such cards now.

Futures classes are unacceptable because they deprive individuals of their right to notice an objection, both rights guaranteed under Rule 23(e). Both the Supreme Court and the Second Circuit, as well as numerous district courts, have suggested that such an open-ended class definition is unacceptable.

The plaintiffs and Mr. Korologous's response today is to say that future merchants receive exactly the same benefits as current members of the class. First of all, I don't agree that's correct. A hypothetical individual who starts accepting cards in five years doesn't get the same

indivisible relief, they only get five years. But if they don't get to ten years, the settlement assures.

THE COURT: Well, but the relief doesn't have to be identical for it to be lawful. In other words, it could be that one company gets more benefit than another company from the relief. But if the relief is lawful and appropriate, then they get as much relief as their circumstances permit.

THE JUROR: Well, I think (b)(2) requires more than just being lawful and appropriate. I think it requires more indivisibility than that. But even if --

THE COURT: On your theory you could never have a settlement that envisioned that --

MR. SCHULMAN: People coming into the class later.

THE COURT: People coming into the class later. Is that the law?

MR. SCHULMAN: I believe that that would be the law. I think, if you look at Amchem, it said that the concern of futures classes, it raises -- that they recognized the gravity of the question, they rejected the settlement on other grounds. But I think that if they had reached the question, they would have said that that's the law, and it hasn't been teed up.

And the Second Circuit said something similar in I think Stephenson versus Dow Chemical. But even if you viewed that as indivisible relief and the future class members are

receiving the same as current class members, that's not relevant. What's relevant is that they never received notice, they never received an opportunity to object. And Buckeye has the right not to have its claim the way this part of a class that's overbroad and unascertainable like that.

Now I'd like to discuss the fairness of the settlement terms for a moment. There are two overarching components of this settlement in our view. There's a cash component of just over $75 million. As we note from In Re Dry Max Pampers and a variety of other cases cited in our objection, this is a real component of the settlement even though it's formally segregated from class relief. It's a component that the defendants were willing to put on the table. Nearly 100 percent of this component is going to class counsel and the named representatives.

Then there is the injunctive component. American Express will amend its standard contract to permit parity surcharging for at least ten years following the effective date. Professor Hemphill has concluded, of course, that the value of this proposed relief is highly uncertain with a substantial probability that its effect will be small or zero.

So that's the potential upside, but there's another half of the equation that needs to be considered, the potential downside for class members. That is more specifically the concessions that the settlement makes on

behalf of those class members in waiving their rights to assert antitrust claims after the provisions change date until the settlement release as long as American Express abides by its obligations to comply with the injunctive terms of the agreement.

With this future looking release, it's no mystery why American Express is advocating so vociferously for the settlement. Whatever benefit there exists in American Express's agreement to allow parity surcharging is more than offset by the concessions that the parties seek to have the court memorialize. For good reason, the law doesn't authorize class action attorneys to impose these future costs on absent class members, especially on class members who are not even permitted to opt out of the agreement.

The law doesn't allow the parties to overwrite the statutory text of the Sherman Act and bind absent class members to the parties' conception of what the scheme should look like. But it's even worse to pretend when valuing the settlement that these costs and concessions are not part of the arrangement when they clearly are.

I've reviewed and scrutinized hundreds of settlements and I cannot recall any other settlement where a full 18 paragraphs of the agreement and many more subsections are devoted to detailing the class's release. Detail itself is commendable but the number of paragraphs here only lets us

know how enormous the scope of the release is. It does little to clarify what is and what is not release.

We can't know how great these costs imposed by the release will be, because no one knows what the relevant market will look like in five or ten years and whether the contractual scheme imposed by this settlement will comply with the antitrust laws in that context.

If American Express's release from large scale liability based on future conduct, it's entirely possible that this is a negative value settlement for class members. Such settlements are prohibited by the Class Action Fairness Act, specifically by 28 U.S.C. Section 1713.

Another problem with the prospective release of claims is that fundamentally American Express is in the driver's seat. Because of the nature of private enterprise, American Express dictates its future course of conduct. So prospective agreements that waive future claims are tantamount to a game of chess where the defendant is always playing as white. For example, the release includes, quote, the future effect in the United States of the continued imposition or of adherence to any rule or provision identified above, any rule or provision as modified by this class settlement agreement, and any rule or provision that is substantially similar.

Now, what does that say about the situation where American Express continues to adhere the requirements of

Paragraph 8 of the settlement agreement but adds in some new term into the merchants' contracts that may violate the law?

What does it say about how to interpret whether a modification goes beyond being --

THE COURT: Slow down.

MR. SCHULMAN: I'm sorry, I'm trying to get everything in.

THE COURT: Well, if you go a little over and you still have something to say, I'll let you say it.

MR. SCHULMAN: Okay.

THE COURT: No reason to race through it because I have to be able to absorb it.

MR. SCHULMAN: Good point.

THE COURT: And the court reporter has to be able to memorialize it, which you would like of course.

MR. SCHULMAN: Good point, your Honor.

THE COURT: Go ahead.

MR. SCHULMAN: So what -- the agreement doesn't say anything about what is substantially similar or not. What is clear is that American Express is in the driver's seat.

To put this another way, the terms of the prospective agreement are way overreaching by releasing future conduct class members' claims that the parties have no right to release and at the same time not detailed enough by preventing wiggle room that could prevent the class from

obtaining any benefit of the bargain.

I don't say this to impugn the competence of the attorneys for the settling parties in ironing out the particular terms. I'd rather -- what I mean to say is that the error was in even trying to come to this type of future looking agreement in the first place. This is not the type of agreement fit for settlement of a class action lawsuit pending before an Article III tribunal. It's more like a consent decree that the DOJ or FCC might reach in an enforcement action. I strongly the court to look at Judge Chin's decision in Authors Guild v. Google, a 2011 settlement rejection out of the Southern District.

Fundamentally, there is a misconception of the role of class counsel that is present. Class counsel are fiduciaries and trustees for the absent class members. Class counsel are not mediators of a prospective business arrangement between absent class members and the defendants for which they'll entitle themselves to a 75 million-dollar brokerage fee.

The settling parties have stressed the importance of compromise and there's something to that notion. But a valid compromise is arriving at some settlement between the amount sought in the complaint, billions of dollars, and the amount that would be received if the case was wholly unsuccessful, zero dollars. Never, ever should the class be put at risk of

being worse off than they would be if the suit was never filed. But here that's just what the release of future claims does, it risks the class being put at a worse position than if the suit was never filed in the first place.

Finally, I'd like to touch on the fee request in the event the court is inclined to reach that question. For multiple reasons, the request cannot be approved consistent with Rule 23(h). Procedurally, the plaintiffs ask for a lodestar-based award without the submission of billing records Second Circuit law does not permit this. But now confronted with this argument, the plaintiffs rationalize that this rule only applies to contested fee shifting pursuant to civil rights in labor laws, yet the class action subcontext is no different. If anything, the scrutiny must be even more vigorous.

Federal Rule of Civil Procedure 23(h) requires that class members receive notice of the fee motion and an opportunity to object to the same. The advisory committee notes for 23(h) presuppose that there will be plenary oversight by both class members and this court, yet class counsel's argument is that they are permitted to conduct the oversight themselves and then file a bare bones summary of their work. That's wrong.

Class counsel has deprived everyone of the ability to scrutinize their fee requests. And substantively the

75 million-dollar request is also untenable because it's excessive. A 75 million-dollar fee award would be commensurate with the demonstrated benefit of roughly $600 million, yet as Professor Hemphill makes clear, the demonstrated benefit here is precisely nothing. And as I mentioned earlier, the potential cost to absent class members of the future looking release is great.

Class counsel has not cited any other settlement that obtained only injunctive relief and where class counsel was awarded $75 million in fees because it's very likely that none exists. The class benefit, or lack thereof, is relevant even if the court had records sufficient to apply the lodestar method. As the Ninth Circuit said recently in In Re HP Inkjet Printer litigation, plaintiffs' attorneys don't get paid simply for working, they get paid for obtaining results. Appropriate use of the lodestar calibrates the award downward where the degree of success is limited.

Here the plaintiffs seek their entire punitive lodestar or close to it. Even though the class is being asked to settle for no compensatory relief at all, they seek to use their crude lodestar to insulate themselves from the risk of pursuing an unprofitable case, something the court cannot and should not do. I welcome any questions.

THE COURT: I would only mention that I think that your analogy of a brokerage commission to legal fees doesn't

appear to me to be necessarily appropriate where, you know, brokerage fee is earned based on a contract where the result will afford the brokerage fee whether the broker spent five hours or 500 hours to bring the parties together.

Legal fees, as you pointed out, are subject to the court's review of billing records and other appropriate evidence of the work that was done and the nature of the work, the benefit, and so on. So I'm not --

MR. SCHULMAN: I agree completely. That's my entire point, is that they shouldn't be trying to act as a mediator. They are just representing the plaintiffs. They're not representing the plaintiffs and defendants trying to get them to a settlement at any cost. That's exactly the point of what I'm trying to get across, that they misperceived themselves. They've abandoned the fiduciary role because of the possibility that the settlement could be a negative value settlement for certain class members or for the entire class.

THE COURT: You're saying they're fiduciary and they're also an advocate at the same time?

MR. SCHULMAN: For the class. That's -- that's what their role is supposed to be and they acted in this settlement more like a mediator, that's our view. And that is not appropriate.

THE COURT: And you would like to take the settlement and ignore everything that came before the

settlement, in other words, all the litigation that happened before the settlement, and unsuccessful as it was in Italian Colors, so you want to limit this to just the narrow scope of the negotiations with American Express?

MR. SCHULMAN: No, no, no, that's not what I'm saying. I'm not saying that they can't be compensated as lodestar for that work that was put into the case.

THE COURT: Okay.

MR. SCHULMAN: What I'm saying is that their role is not reaching settlement at all costs. If it risks a potentially negative result for their clients. And that was the -- that was the mistake of the settlement in our view.

THE COURT: Thank you.

Okay. The next speaker is John Pentz.

MR. PENTZ: Yes, your Honor. Good afternoon, John Pentz on behalf of Unlimited Vacations, Lasko Enterprises and The Silk House.

THE COURT: And Unlimited Vacations, do they have any trade names or are they just Unlimited Vacations?

MR. PENTZ: They're just Unlimited Vacations, a travel agency, your Honor.

THE COURT: Proceed, please.

MR. PENTZ: Well,WELL, there are plenty of reasons not to approve this settlement today. As we heard this morning, first of all you cannot use 23(b)(2) to release

future claims. Number two, the lead plaintiffs are neither typical nor adequate to represent the absent class members here. Class members -- number three, class members are differently situated. And number four, as Professor Hemphill has found, the proposed -- the only relief that could possibly flow to the class is likely to have no value.

But the class counsel and American Express are trying to trap you with a false choice. They say that unless continued litigation in this case can produce a better result than this settlement, you have to approve the settlement no matter how little value anyone may find it might have.

Now, while that is typically true in a lot of consumer cases that hit a brick wall, for example, another circuit might issue a decision that guts the case and assures a defendant a victory, at that point the parties may enter into a settlement for coupons of dubious value, but the court may nevertheless -- typically courts do approve those settlements because they make a finding that the claims have zero litigation value.

Now, those settlements are approved sometimes upheld but they differ in two major respects from this settlement. Number one, in those cases the only thing that's being released are the claims that have already accrued and have already been found to have zero litigation value. And number two, those cases do not release claims that may accrue in the

future for future conduct and essentially tie the class's hands to ever raise the same claims again. Essentially they just wipe the slate clean and the class is free going forward to bring the exact same claims.

Class counsel this morning raised the specter that this case will go on for quite some time and may even work its way back up to the Supreme Court again. Well, so what? Who cares how long this case takes to eventually, you know, die it's last whimper. That's not the comparison. The comparison is what other class members can do in future arbitration and future litigation. As we saw today, some of the objectors ultimately after they go through mediation and arbitration have a right to file a case in court. And it's those -- it's that litigation to which this settlement has to be compared not what happens to this case once your Honor rejects the settlement, because I think everybody agrees, this case is as Mr. Shinder called this morning, defunct.

Not every failed case has to end in a bad settlement. And while typically it provides a way out for both parties and it gives class counsel a little bit of compensation for their failed efforts, this is a case where what the parties proposed is much worse than that. I agree with Mr. Shinder and with Mr. Schulman that this is a negative value settlement. In other words, the class would be better offer if this case had never been filed. They'd be better off

with the possibility, the threat that they can still bring an antitrust class action for the practices of not permitting differential surcharges.

With respect to the fees, I take a little bit of a different approach than Mr. Schulman. I do agree that the 75 million that American Express has agreed to pay the class counsel in fees is pretty much the salvage value of this class action. And it's all flowing, all the cash is flowing to class counsel and none of it is flowing to the class. Now, of course, 75 million in the context of the damages demanded here is a pittance, it couldn't possibly be distributed. So that's not my chief objection to the fee.

But the maximum fee in this case would be class counsel's lodestar if they achieved a settlement that permitted differential surcharging. The holy grail. According to Perdue v. Kenny A., a successful plan, one that prevails after trial is entitled to his or her lodestar and no more. In this case and also Hensley v. Eckerhart requires the fee to reflect the plaintiff's degree of success. If you haven't achieved 100 percent success in the case, you're not entitled to 100 percent of your lodestar. So if the lodestar would be the fee for achieving the right to differentially surcharge, what would be an appropriate fee for achieving what they've achieved here which is parity surcharging? I would submit it's less than 50 percent of that lodestar.

And with that I'll rest. Thank you, your Honor.

THE COURT: Thank you very much. Okay. And now we'll hear from Mr. Lowrey who represents Home Depot. Mr. Lowrey, welcome.

MR. LOWREY: Thank you, your Honor. I think the most important question you asked today came when the plaintiffs were extolling the benefits of parity surcharging. And you asked, and I wrote it down, what is the benefit of this settlement if you are wrong. And plaintiffs argued with your premise, but everybody in this courtroom knows that the answer to that question is none, your Honor, no benefit if we're wrong.

Now, the release is going to be exactly the same. We're going to release all rights to challenge all rules except for the ones they modify. That release is going to last for at least ten years, plus as long as American Express and Visa and MasterCard maintain their current rules. That release is going to apply regardless of the future market effects. That language was read to you earlier, it's in the settlement agreement.

Should the markets change in the future such that these rules have an anticompetitive effect they do not have now, you will have taken away the right away from us to bring that claim.

Ultimately what the plaintiffs want you to do here

is they want you to predict the benefits of limited surcharge and predict that those benefits are going to outweigh the cost of the immunizing all of the rules that are immunized from challenge by the settlement.

Now, your expert said that the benefits of this settlement are highly uncertain, there's substantial probability that the effect will be small or zero. I don't know how your crystal ball works, mine has proved horribly unreliable. I remember in the 1990s, I told one of my law partner, why are you talking about getting a website, no one is ever going to hire a law firm basined on what it says on the website. And now Martindale-Hubbell books they're just in furniture stores to fill up the loose space on the shelves.

Predicting technological and market developments for the next ten or 20 years is a lot to ask of anyone. You could hold this hearing for a year, you could hear from an expert every day, we could all go to Australia, take a field trip, we could all go rent cars, and at the end of all of that, the best you'd ever be able to say is maybe, maybe this settlement will produce a benefit. So I submit that is the last kind of settlement you should be forcing on everyone with no right to opt out.

You asked, markets might change in the future, maybe a new investor group will come in, start a new credit card company. Well, this settlement takes away our ability to

reward that innovation and reward the low cost competitor. If their interchange fee is lower than American Express's, we have to drop the surcharge to match the new entrant's lower interchange fee. That wouldn't produce any competitive pressure on American Express, we couldn't reward that new low cost competitor by discriminating in its favor or steering business to it.

So one of the major issues we have that this settlement really comes down to the adequacy of any group of merchants, this one or any other group of merchants making those choices for everyone.

The case law tells you that adequacy of representation requires your crucial scrutiny under two circumstances; one is when there is going to be a settlement and there's not going to be a trial where you get to thoroughly understand, hear all the evidence, hear all the witnesses, and the other is a settlement where there is no opt-out right like this one.

Now, the plaintiffs' answer to that is to say just look at the paper, your Honor. If you just look at the four corners of the settlement agreement, all merchants are getting the same rights and they're giving up the same rights so we must have an adequacy of representation to do this on everyone's behalf. But that's the wrong analysis. We're giving up a list of rights and we're getting some rights.

The problem is merchants value these rights very differently. So, think about it for a minute. Wouldn't it be amazing if 6 million merchants, current or future, regardless of their size or their leverage, vis-a-vis American Express, regardless of what kind of contract they have negotiated with American Express, regardless of their business type, their customer base, the regulatory structure they answer to, the location, it would be amazing if all merchants actually valued the various rules that we give up or the various rights we give up under this settlement the same as the rights we're getting. That's something that would have to be proved to you, and I can't even imagine the evidence that would prove it. But I don't have to because that evidence is completely missing from this record. There's no evidence that the rights that are taken away are valued by all merchants less than the rights that are given. There is a conflict. Why should one small group of merchants, this group or anyone else get to make that choice for everyone?

Why is their judgment about what's good for our business better than our judgment about what is good for our business? I think the court has already remarked that the volume of American Express transactions represented by the objectors essentially dwarfs any volume represented by the named plaintiffs. Not your words but I think that the record is clear on that. Why did they get to make the decision for

us?

If you were going to make a decision on this and you could build an annex to this courthouse and get all 6 million merchants in here, the last thing you would do is say, hey, you four, what do you think. Okay, that's what we're doing, everybody else, what they said. You'd never do that. But that's exactly what they're asking you to do here.

What's the alternative, they say? Well, look, this case doesn't have to proceed as a class action at all. The alternative is simply that you don't involuntarily extinguish our rights. If that means there's no settlement, there's no settlement. If that means that you don't certify this class at all and just allow these plaintiffs to proceed on their own against American Express, so be it. But the answer is let everyone decide for themselves. That's our right.

And the plaintiffs' answer to that is, well, if the large merchants aren't in this, how do we ever help the small merchants. Well, they might as well stand before you and admit that they're taking our claims and using them to subsidize relief from merchants that couldn't get it without our claims. And that is a classic conflict of interest. They are selling off the large merchant claims to get relief for the small merchants. That is a conflict of interest and represent no group, not criticizing this group, no group would be adequate to make that decision for everyone.

THE COURT: But your client, along with other objectors are extremely large merchants have a great deal of leverage in the process of negotiating merchant agreements with -- the merchant agreement with American Express. So you have -- those small merchants don't have a seat at the table. You have a seat at the table. And you and other large merchants, as was shown at the trial that we had over the summer, do indeed negotiate specific terms that are beneficial to them in a give and take situation. So you really -- in that sense, you have a great deal of leverage in dealing with American Express that the smaller merchants who are also members of this proposed class do not have. How do you address that?

MR. LOWREY: Well, a couple of things about that. That leverage is not translated into a favorable interchange fee, I can tell you that. That's one thing.

They may not have the same seat at the table they do, "they" being the small merchants, but that's why there's a conflict here. They can't take our seat at the table. They can't force us to stay at the table to protect them. You know, it's not our job to look out for anyone but us. And if the class has conflicts like that, you don't certify a class and impose a solution on everyone.

We may have more leverage than the small merchants, that doesn't mean that we can afford to give up all of our

legal rights to challenge their entire slate of rules except for this one. We can't afford to do that. We need to resort to the legal system and it can't be taken away from us without our consent, which is really the major point that I want to emphasize.

To me, it is absolutely clear under the Dukes decision that this settlement cannot be imposed on us without opt-out rights. When you go back tonight and you read Dukes, because I know you're going to jump right into this, read Section 3 and mark with your red pen.

THE COURT: I've read Dukes a number of times.

MR. LOWREY: Well, you probably highlighted the same passage that I did.

THE COURT: We venerate Dukes.

MR. LOWREY: I sleep with it under my pillow myself, your Honor. Your copy of Dukes probably has the same passage highlighted that mine does.

THE COURT: Okay.

MR. LOWREY: And it's the one that talks about how even a properly certified (b)(2) class that predominates over damages, even if you have those things, properly certified (b)(2) class that predominates, you still can't take away individualized damages without a right of opt-out. Now, the plaintiffs' answer to that is, wait, we're providing only injunctive relief, we're not providing any damages. Because

we're providing only injunctive relief, we can release and settle your damages claims. That can't be right. It can't be right.

The Supreme Court says the opposite of that in Dukes and I found -- I mean, I honestly think that that point doesn't need authority but I found some. There is a good decision called Richardson versus L'Oreal. It's reported at 991 F Supp. 2d 181. And the good stuff is on page 199. That's a District of DC decision. And the exact point that court made, you heard the same argument the plaintiffs made here because we aren't giving any monetary relief. We can simply extinguish damages claims about allowing a right of opt-out. And the court said that's absurd, that's exactly what Wal-Mart rejected.

THE COURT: Who was the judge in that case?

MR. LOWREY: I don't have that written down, your Honor. Obviously a very wise jurist.

UNKNOWN SPEAKER: Judge Bates, your Honor.

THE COURT: I'm sorry?

UNKNOWN SPEAKER: Judge Bates, your Honor.

MR. LOWREY: As I said, let me acknowledge right now because you'll hear it on rebuttal, the Visa/MasterCard approval order rejected this argument. I admit that. No secret about that. What the Visa/MasterCard approval order says is -- there are two sentences that really address this

issue.

The first one: Rule 23 contemplates binding settlements with no opt-out rights where the injunctive relief achieved by the settlement is appropriate for the class as a whole. No question that's true. But it doesn't contemplate binding settlements with no opt-out rights where you're extinguishing individual damages.

The other sentence is this one.

THE COURT: Is this the sentence from Judge Gleeson's decision?

MR. LOWREY: It is, your Honor, at page 41 of the docket entry version.

THE COURT: Go ahead.

MR. LOWREY: The second sentence says this, The (b)(2) settlement here is limited to going forward injunctive relief that changes the structure of the network's practices. Also absolutely true, but the release is not. The release in settlement is not limbed to injunctive relief. It wasn't in that case and it isn't here. The release here encompasses all of our future damages claim. And that's what you can't do without letting us opt out.

So the plaintiffs say, well, judge, no one would settle (b)(2) claims if you couldn't release related damages. Now, let's be clear about one thing. The damages claim we're talking about are not damages that somehow flow from them

allowing surcharge, right? They're not going to violate the antitrust laws by letting us do stuff. The damages claims we're talking about are from the list of rules that they have now and that they get to have forever, or at least ten years plus under this settlement.

But I acknowledge that, (b)(2) is no use to you if what you want to do is have final relief that extinguishes all individual damages claims. We sell tools at the Home Depot and if someone bought a screwdriver and came back to us and said, look, this screwdriver is defective, I can't use it to drive nails, one of our guys in the orange apron would say, politely I hope, you got the wrong tool. And that's the problem here. (b)(2) is the wrong tool if what you want to do is extinguish future damages claims. Is that inconvenient? Well, yeah, it's more inconvenient than having to give people notice and the opportunity to opt out. But due process is an inconvenience. The rules are chock full of inconveniences.

A couple of points on the authorities they cite. They cite Robertson versus NBA. That was decided 34 years before Dukes by the Second Circuit, can't possibly govern here. There's a typo in the plaintiffs' citation on it on page 44 of their reply brief. They quoted as saying preclusion of the opt-out right in a (b)(2) settlement does not violate due process. The actual text in the case is talking about a (b)(1) settlement. I know that's an

inadvertent typo but my point is just to clarify that Robertson does not address the (b)(2) questions that Dukes does address. And Dukes governs anyway, right --

THE COURT: What?

MR. LOWREY: Dukes governs anyway regardless of what the Second Circuit said in 1977.

They also cite Literary Works, that case, and they cite the Wal-Mart v. Visa decision. And those were both cases where there were broad releases including future claims in Literary Works. And in both cases, there was a right of opt out. In Literary Works, there was a right of opt out from the future copyright release portion of the settlement. And in Wal-Mart versus Visa the very point the court made is, yes, this release is binding. If you didn't want to be bound by it, you should have opted out.

Well, that's what we would like to be able to do here and that's what these plaintiffs seek to deny us the right to do.

THE COURT: You think there would have been a settlement with an opt-out provision?

MR. LOWREY: I don't know. They obviously have to tell you no, right? If that's like the story about you buy my lawnmower for 70 or 80 dollars, and your response is well, obviously 80 is out of the question. I mean, they obviously can't show up and say, yeah, we would have done the deal

either way. They've got to say, it wouldn't be a deal if you allowed opt-outs.

But let's assume for a moment there wouldn't be a deal if opt-outs were allowed. All that shows is that they have to take the claims of the large merchants as part of the settlement, that they're using -- they're buying off our claims for relief we consider to be worthless or very little value and taking our rights.

They haven't really tried to make the argument that our damages claims are merely incidental, I don't think their heart would be in it anyway. But to the extent they do argue that, let me speak on that briefly. And I may run a few seconds over if that's okay.

THE COURT: Go ahead.

MR. LOWREY: Our damages claims can't be viewed as merely incidental under Dukes. Their first explanation of why they're merely incidental is to say, look, you're just giving these up basically to make the injunctive relief work. In so many words, because your getting injunctive relief we've got to take your damages claims. Well, if that argument made damages claims incidental, then they would have been incidental in Dukes and they would be incidental in every case where all you grant is injunctive relief.

The key thing here is that our antitrust damages are just as individualized as the back pay damages were in Dukes.

They depend on each merchant's experience and leverage. What interchange fee could we have negotiated without these merchant rules? There's probably a different answer for every merchant in this room, and it depends on circumstances and size.

I would add this, unlike back pay, which for some reason had traditionally been viewed as equitable and appropriate for (b)(2) relief. If the traditionally equitable nature of back pay didn't make those damages incidental in Dukes, there's no way our damages at law for antitrust could be incidental.

You know, in our future damages that's a very valuable right. You know, troubled damages in the future would compensate us for any violation but it would also deter future conduct. So troubled damages double as an injunction. It gives you most of what an injunction would give you plus three times every dollar you lose. That is an extraordinarily valuable right that can't be taken from us without the right to opt out.

Those are really the remarks that I had planned to make, your Honor. Any questions particularly about Dukes? I mean, to me that issue is absolutely clear so much so that I don't see the counterargument. So if there is any -- if there is any different view or out that we could test, I would appreciate the opportunity to do it. But if you've heard the

answers to everything, then I'll...

THE COURT: Thank you very much.

MR. LOWREY: Thank you very much.

THE COURT: Before we go any further, I see the senior partner from Cravath, Swaine & Moore is here.

MR. GOLD: Good afternoon, your Honor.

THE COURT: Good afternoon. Nice to see you, Mr. Gold.

Now, when I walked in this building this afternoon, Mr. Chesler was walking in. And now there's no Mr. Chesler. So is this a test for my powers of observation?

MR. GOLD: I'm now going to try to play the role.

THE COURT: But he came into the building this morning.

MR. GOLD: He did, but he had a prior engagement that required him to leave.

THE COURT: Oh, all right. Okay. I thought it was something I said.

MR. GOLD: No, your Honor.

THE COURT: All right. Thank you.

At this point we're up to Southwest Airlines, et al. Mr. Slater, good afternoon, sir. Nice to see you.

MR. SLATER: Good afternoon, your Honor. Paul Slater on behalf of the Southwest Airlines group and also the individual independent merchants.

Your Honor, before I start I'd like to hand out a couple of documents that I'd like to use for the court.

THE COURT: Do you plan to put anything up on the screen?

MR. SLATER: No. And I'm not even sure I'm going to use the three documents that I have.

THE COURT: Go right ahead.

MR. SLATER: Thank you, your Honor. A fair amount of what I had planned to say has already been said by others and I won't repeat it.

THE COURT: Thank you.

MR. SLATER: What I would like to do is address four specific points and then a recap of the Grinnell factors that control this court's decision. The first issue I'd like to talk about is the purported need for uniformity in the enforcement of the antisteering rules. AmEx claims in its papers that the antisteering rules must be uniformly applied to all merchants.

This is the only justification which is given for why we have a non-opt-out class which imposes on the objectors and certainly on the individual merchant plaintiffs a release which is not to their liking.

AmEx never explains why it is that uniformity is required in the application of their antisteering rules, they just say it. The contention, your Honor, as was noted earlier

today, is contrary to the evidence of the testimony at the trial during the government case. Mr. Quagliata, the AmEx employee -- and I got some of that testimony in those documents that I've handed you, but they've already been put up by Mr. Canter.

Mr. Quagliata very clearly said that for large merchants that they negotiated the individual exceptions to the antisteering rules and they do not apply those rules uniformly to all of the large merchants. So there is no need for this purported uniformity.

Now, a few minutes ago your Honor inquired as to whether the ability to negotiate with American Express gave or indicated that the large merchants had some leverage with American Express. It does not, quite the contrary. One of my clients, Southwest Airlines, testified at the trial. AmEx went to them and said, we're raising your price. I won't go into the numbers because they're confidential. AmEx said to Southwest Airlines, the largest airlines in the United States of America, tough, we're raising your price. There's nothing you can do about it.

The reason that there's nothing the merchant can do about it is because the merchant can't respond to differential surcharging or, as Mr. Arnold said, differential pricing. The merchant can't say, well, you can raise my price but I'm going to pass it on to the consumer and if he doesn't like paying

that price for your supposedly wonderful service, he'll migrate to a different credit card, you will lose volume. That's exactly what is supposed to happen in a competitive market where price competition, the very touchstone to the antitrust laws where price competition is respected and is allowed to operate.

The reason that Southwest Airlines and the other merchants can't have that leverage is because the antisteering rules, the no differential surcharge rule, no differential pricing rule, prevents them from exercising that incentive, which Professor Hemphill said is the touchstone of horizontal price competition.

So I believe the first point I want to make is that uniformity is not needed in the application of the rules. There's no justification for imposing this release on the unwilling objectors, and that the fact that the large merchants can negotiate with American Express does not mean that they have leverage with regard to the pricing issues.

The second point I want to cover is with regard to the humanness of objectors. The classes contend that there are very few objectors and that this weighs in favor of approval. Your Honor, I would submit that exactly the opposite is true. There are very few proponents. The only merchants in America who step forward to support this settlement are the few relatively small plaintiffs represented

by class counsel.

There are a great many objectors and, as your Honor has noticed, they are the largest merchants in America. Your Honor, under Tab B in the documents that I've handed out, this is Exhibit 8 to the report of the Dr. Vellturo, his opening report submitted on April 3, 2013. And Dr. Vellturo is one of the expert economists for the individual merchant plaintiffs.

This is a list of the hundred largest retailers in the United States as of 2011. Your Honor, 19 of the top 20 merchants on this list are here in this courtroom objecting to this settlement. Twenty-four of the top 27 on this list are here objecting to this settlement. The other three merchants aren't here at all. They don't -- it's not that they support the settlement they just haven't weighed in.

The list of objectors reads like a who's who of American retailers. You've got Wal-Mart, Target, Costco, Home Depot, BestBuy, Sears, Amazon, Staples. Your Honor, I can go on, but you got the idea. All of the major drugstore chains in America are individual merchant plaintiffs. All of them object. That's Walgreen, CVS, and Rite Aid. All of the major supermarket chains in America are here objecting to this settlement. Not one major merchant, your Honor, has stepped forward to say that they support this settlement. Not one.

Not one major merchant in America has stepped forward and said that they would parity surcharge or that it's

of any value to them. None. The handful of small merchants represented by class counsel do not speak for the major merchants and they cannot possibly be an adequate representative for the major merchants.

Let me move to the next subject. The class claims that, quote, the great majority, the great majority, their term, of surcharging in Australia is parity surcharging. They also claim that most merchants who surcharge in Australia, and I quote again, apply the same surcharge to all brands. Your Honor, that contention is incorrect.

In 2007, class counsel asked East & Partners the source of the data which is the fount of their argument. They asked East & Partners to do a special report for class counsel. Class counsel didn't reference this in their papers but I've attached it in that little folder. This is under Tab C. This is the merchant surcharging in Australia market analysis report addendum for the Friedman Law Group, LLB.

Your Honor, at page 2 of the report it says this: The average surcharges applied by merchants on charged cards, AmEx and Diners, are typically twice the average surcharge on credit cards. So in Australia the average rate which AmEx is surcharged is more than double. The chart below shows that Visa and MasterCard are surcharged at an average rate of 1 percent. AmEx's average surcharge is 2.1 percent. It's a little bit more than double the rate.

The majority, the vast majority of the surcharging in Australia is differential surcharging. In fact, at page 3 of the same report, it says that of the merchants who surcharge, and I quote, the majority surcharge differential with charge cards -- remember that's their term for AmEx and Diners Club -- with charge cards clearly targeted more than credit cards. The merchants in Australia differentially surcharge. The impact of that is enormous, it drives rates down.

We've cited to your Honor, and again I won't go into the data because it's under protective order, but we've cited to your Honor instance after instance of where a large merchant was able to go to AmEx in Australia and say, I will differentially surcharge your card unless you lower your price. In other words, let the downward bidding begin. Let the price competition begin. And AmEx reduced their price by enormous magnitudes in response to the ability to differentially surcharge.

Your Honor, the East & Partners report from 2009, which was cited in our papers, says the same thing. The East & Partners report from 2010 and 2012, again, says that higher priced cards, that would be AmEx and Diners, are surcharged more often and they're surcharged at a higher rate.

Your Honor, I have one final observation, then I'll get briefly to the Grinnell factors. And the observation is

this: This settlement puts, I believe, the court and certainly the individual merchant plaintiffs in an unfair posture. Now, why do I say that? The class and AmEx agree that the individual merchant plaintiffs are entitled to a trial on their past damage claims, no matter what happens with this settlement.

Let's assume that we go forward and we prove at trial that the ban, the prohibition on differential surcharging is unlawful. Let's assume the court has approved of this settlement. Here is the uncomfortable position in which we would find ourselves. The individual merchants will have established that the ban on differential surcharging is unlawful. But we will have been ordered by this release to not challenge or enjoin the continuation of that unlawful behavior and we would have been ordered by your Honor that we can't seek damages for the continuation of that unlawful activity.

Your Honor, I do not believe that any settlement which has the potential for resulting in that event where we've established the illegality and are denied any remedy going forward, I don't believe that any settlement that does that could possibly be characterized as fair, adequate or reasonable.

Let me move briefly to the Grinnell factors because I really don't think the class can establish a single one of

them.

THE COURT: Do you think the question that you just raised is a question of law?

MR. SLATER: Your Honor, could I pump the question by saying it's probably a mixed law question of fact.

THE COURT: Well, if it's a mixed question, then it's a question for the court. If it's a question of fact, it's a question for the jury. I'm just wondering --

MR. SLATER: Oh, maybe I didn't understand your Honor's question. Are you asking whether the question of whether the prohibition on differential surcharging is a question of law or a question of fact?

THE COURT: Right.

MR. SLATER: It would be for the jury to determine whether the prohibition on differential surcharging amounted to an unreasonable restraint of trade within the meaning of the Sherman Act.

I also believe that as a matter of law a direct prohibition on horizontal inter-brand price competition is a violation of the Sherman Act. So, again, I would say that as a matter of law what they've done is unlawful. If we thought that it would have advanced things, we would have filed a motion for summary judgment on that grounds. But given the history of summary judgment in the Second Circuit, we decided it would be better just to try the case.

But do I believe as a matter of law a ban on horizontal inter-brand price competition is unlawful? Absolutely. It is the paradigm sim of the Sherman Act. It's the one thing you cannot ever do.

THE COURT: And so we can have a jury trial and the jury could come up with an answer and there could still be a judgment based on a question of law afterwards?

MR. SLATER: Procedurally, Judge, I honestly don't know the answer to that question.

THE COURT: Well, it's pretty complicated. I'm just trying to get some help.

MR. SLATER: Yeah, and I wish I could --

THE COURT: I'm sure everyone will be willing to help me later on. I'll wait on that. We're jumping way ahead of ourselves here. Go ahead.

MR. SLATER: Let me move quickly to the Grinnell factors, your Honor.

The first factor is the complexity, duration and expense of the litigation that is left. In other words, how much expense and litigation is left to be done.

With regard to the individual merchant plaintiffs, Judge, none. We've already gone through all the hurdles and all the hoops. We've completed fact discovery, we've submitted three rounds of expert reports. As your Honor knows, we've done the expert depositions and we've briefed and

argued summary judgment. There's nothing left for us to do. We've suffer -- or no gain no benefit in the reduction of the burden on us by a resolution now not to our liking.

THE COURT: By the way, and this has nothing to do with the fairness hearing, how long do you think your case would be to present at trial? Have you thought about that?

MR. SLATER: Can I deter to Mr. Arnold on this one?

THE COURT: I could plan the rest of my career here.

MR. ARNOLD: Your Honor, Richard Arnold on behalf of the individual plaintiffs. We think that depending on the ruling in the DOJ case, if the DOJ prevails, there's going to be some preclusion issues regarding American Express. But assuming just in a vacuum without presuming any of that, we think, and having sat and watched this trial, as well as you kept that chest clock we think 50 hours for each side we can try the case.

THE COURT: Fifty hours?

MR. ARNOLD: 50 hours, yes, your Honor.

THE COURT: I was just curious.

MR. ARNOLD: Yes. On each side, I mean they obviously --

THE COURT: No, I understand that. I got it. All right. Thank you.

MR. SLATER: Your Honor, the second Grinnell factor is the reaction of the class. I would submit that the

reaction of the class was very, very heavily against the approval of this settlement. Not one merchant has stepped forward to say they support the resolution.

The third factor is the state of the proceeding, the amount of the discovery completed. Again, in our case all the discovery is completed, we're ready to go. In the class case, no class representative has ever been deposed. There has been no class discovery taken either by AmEx or by the class itself. There have been no expert reports, no expert depositions and of course no summary judgment practice.

It would be upside down, Judge, to put the less prepared case in a position of preference over the more prepared and ready to go. So we submit that this factor weighs heavily against approval.

The fourth factor is the risk of establishment liability. Mr. Arnold addressed this. We think the case on the merits is extremely strong. We think the defense is very weak. And we think the settlement and resolution is very weak. The comparison of the quality of the settlement and the quality of the relief to the strength of the merits of the case weighs heavily, heavily against approval.

The risk of establishing damages is the fifth factor. Your Honor, this one can't possibly help the class because each merchant, according to the settlement they've reached, would have to go to his own individual

arbitration to establish his own damages. No burden is alleviated by the quality of this settlement.

The sixth factor is the risk of maintaining the class through trial. Again, your Honor, this factor is very, very clear. We know what the risk is, that this class will be able to be held together. The class acknowledges that due to Italian Colors it has no damage claim and cannot proceed as a damaged class. We know from the motion filed by American Express that it's very unlikely that they have no claim for injunctive relief either.

The posture of this case, and the likelihood of maintaining a class through trial is functionally zero. That's precisely why the class should not be permitted to settle against our will of our claims. Excuse me, can I get a glass of water, Judge?

Your Honor, the seventh factor is the ability of American Express to withstand the greater judgment. Two points. They can clearly withstand a greater judgment of $75 million.

With regard to injunctive relief, it's clear from Australia that they can withstand a judgment that says merchants can differentially surcharge. That's effectively what happened to them in 2003 due to the order of the Reserve Bank of Australia. They're doing fine in Australia. They had to lower their price and they had to compete on a price. But

that's not a death knell. That's just get in line and get out there and compete with everybody else just like everybody else.

The eighth factor is the reasonableness of settlement in light of the best possible recovery. Your Honor, the best possible recovery here from my perspective is that they're ordered to stop prohibiting differential pricing, let the horizontal inter-brand price competition take hold and let it do its work.

So what's the settlement? As been told to your Honor several times today, Professor Hemphill found the settlement to be of no or little value. The benefits to the class of the ability to differentially surcharge, including the small merchants, Judge, would be enormous. If we go to trial and win, those small merchants are going to be lining up claiming collateral estoppel. And the terrible, you know, fate that will befall them, which has been predicted by some in this courtroom today, is not true. All they'll have to do is figure out what their damages are and batter up.

The ninth factor is the reasonableness of settlement fund in light of the litigation risk. This one is pretty easy, there is no settlement fund.

Your Honor, I've overstepped my time which I really was hoping not to do. I apologize for that.

THE COURT: That's quite all right.

MR. SLATER: Thank you very much.

THE COURT: All right. Next we have Mr. Schwartz representing the United States of America.

MR. SCHWARTZ: Thank you, your Honor. Adam Schwartz with the Civil Division of the United States.

THE COURT: Were you here during the trial?

MR. SCHWARTZ: I was not, your Honor. I am here with Mr. Hamer because there's sort of different forms of relief rather than pursuing an enforcement action.

THE COURT: I see.

MR. SCHWARTZ: The civil division is involved in this matter.

THE COURT: Fine. Welcome.

MR. SCHWARTZ: Thank you. While the other objectors that you've heard from today have raised objections regarding the merits of the case, the United States here is in a slightly different position. We are here, as we said in our papers, because we do not believe we should be here. The United States has never once asked to be a part of the this class, and pursuant tore 28 U.S.C. 516 and 519, the authority to represent the United States is vested in the attorney general or his designee.

THE COURT: Okay, stop. Do the parties to this proposed settlement agree that the United States should not be party to this settlement under the statute that was just

identified?

MR. KOROLOGOUS: I'm not sure I completely follow your Honor's question. American Express --

THE COURT: Well, the government is saying that they shouldn't be covered by the settlement, that they shouldn't be subject to the terms of the settlement if it's approved because of that statute. I'm just wondering whether you have a view on it so that Mr. Schwartz doesn't have to stand here for 15 minutes and tell me all the reasons why.

MR. KOROLOGOUS: We do and we oppose the government's position. We believe that they are merchants.

THE COURT: Okay, thank you. Now you can speak. Otherwise you would have to sit down.

MR. SCHWARTZ: I would gladly sit down if our interests would be protected. But I believe that is the problem here, that those statutes not only refer to instances where the United States is a party to the litigation but also instances where the United States has an interest in the litigation.

THE COURT: And in this case you have an interest.

MR. SCHWARTZ: In this case we have an interest in the litigation as claims for the United States have been included in the class settlement when they were not originally included. In the consolidated class action complaint, in MDL 2221, it excluded all government entities from the settlement

class. The settlement that is before you today includes all governmental entities and there's no carve-out for the United States.

As I said before, the attorney general or his designee has not been involved in the negotiation of the settlement and in fact was not apprised of the settlement until after class counsel and counsel for American Express negotiated the settlement and then provided notice of the settlement to all parties.

American Express nor class counsel can point to a single statute that gives them the authority to represent the United States over the attorney general. The only regulation that they're relying on is Rule 23 of the Federal Rules of Civil Procedure. As the case law interpreting 28 U.S.C. 516 and 519 has said, though, in order for there to be a grant of authority from the attorney general to another individual to represent the United States, there has to be a clear and unambiguous grant of the authority. Nowhere in Federal Rule of Civil Procedure 23 will you find any grant of authority stating that either class counsel or counsel for the defendant in that action has the authority to represent the United States.

We were not party to that litigation and we did not give our consent to be a part of this litigation.

I want to the contrast --

THE COURT: In fact, you have -- the government, the United States has avoided any involvement in the question of surcharging, isn't that --

MR. SCHWARTZ: That's correct. To this point we have. And our interest --

THE COURT: Are you planning to jump in?

MR. SCHWARTZ: Your Honor --

THE COURT: I just want to be forewarned.

MR. SCHWARTZ: At this time, your Honor, the answer to that is no. Obviously the United States is made up of multiple agencies and entities, and the reason that the attorney general has this authority is because there has to be in a sense a clearinghouse for one person to represent the interests of the United States and determine which entity's concerns would take priority over another.

THE COURT: All right.

MR. SCHWARTZ: What I do want to do is contrast Federal Rule of Civil Procedure 23 with the False Claims Act. The False Claims Act, as your Honor may or may not be aware, allows private parties, relators, to bring cases in the name of the government.

THE COURT: I'm very familiar with relators of the False Claims Act.

MR. SCHWARTZ: Excellent.

THE COURT: My docket is filled with the --

MR. SCHWARTZ: Well, we're trying to move them as quickly as we can, your Honor, but as you know, they keep coming and we --

THE COURT: Oh, I have other things to do, so don't bother yourself. Go ahead.

MR. SCHWARTZ: Well, I just want to make point that obviously in the False Claims Act if the government decides not to proceed with an action, there's a provision that expressly gives the relator and his attorney the right to proceed. There's nothing in either the advisory notice or in Federal Rule 23 itself that provides that if the government does not make a decision to opt in or join a non-opt-out class action that the government's claims can be resolved without its involvement. So that is not present here.

One argument that on the papers American Express has made is that 516 and 519 are just ministerial statutes and that they really just deal with how the government internally handles its business. So the attorney general is vested with the authority to represent the United States, but other entities like the FTC or ICC have to go through the attorney general.

I contend that that would create an absurd result where a private party is vested with more authority to represent the interests of the United States than an agency of the United States. So if that authority is granted, then

private litigants in class action lawsuits will be able to resolve any number of claims on behalf of the government without the government ever getting notice of that. This would completely obliterate the purpose of Rule 516 and 519 which is for the attorney general to proceed with litigation and to be a centralized warehouse to handle that ligation and determine what's in the best interests of the United States.

It would create a quagmire and a public policy disaster. There would be no way -- there's hundreds of class actions going on throughout the country at any one time and for the United States to somehow stay apprised of all of these without getting any proper notice and try and figure out whether the interests of the United States are being compromised without any of its involvement would just be an impossible task for the United States to engage in.

THE COURT: Well, but on the other hand, the United States is heavily involved in an aspect of this case. There are basically three elements, three parts to this case.

There's the class action, there's the individual merchant plaintiffs case. Right?

MR. SCHWARTZ: Mm-hmm.

THE COURT: There are those two. And then there's the government's case of the Sherman Act Section 1.

MR. SCHWARTZ: The enforcement action, correct.

THE COURT: The enforcement action. So it is very

familiar with the overall situation in this, quote, case but it has chosen not to involve itself in the class action.

MR. SCHWARTZ: That's correct, your Honor. We've elected to pursue at this time remedy through the enforcement action that Mr. Hamer and the antitrust division is bringing. So we have purposefully not joined this class action and this litigation, and we're now put in a position where the United States for, in my understanding, the first time would be held against its will as part of a class and have to accept class relief and thereby extinguish claims that the government may be able to bring at a later time.

THE COURT: Okay. Thank you.

MR. SCHWARTZ: Thank you, your Honor.

THE COURT: Thank you very much.

All right. Now on the list I have Dashon Hines.

MR. SLATER: Your Honor, I believe Mr. Hines informed us that he would not be here today.

THE COURT: He's not here today? Well, if he's not here, he's not here. Is Mr. Hines here?

All right. I note that Mr. Hines requested time but that he is not here today.

MR. SLATER: We were in communication with him and he told us that other people could use his time.

THE COURT: Oh, well, that's very kind of him.

All right, what we're going to do at this point --

well, let me ask this, is there anyone who is not on the list who is an objector who wishes to be heard at this time? All right. Hearing no one, what remains is the proponents' rebuttal and let's take a ten-minute break and then I'll hear from the proponents. Thank you.

MR. KOROLOGOUS: Thank you.

(Brief recess.)

(Continued on the next page.)

(In open court.)

THE COURT: Okay. Now we'll have deponents rebuttal, Mr. Korologous.

MR. KOROLOGOUS: Good afternoon, your Honor.

THE COURT: How long did you want to take?

MR. KOROLOGOUS: Your Honor, I'm going to make a variety of quick points, I'm not sure exactly how long they'll take, but then the balance of time I will leave to the moving class for the final order.

THE COURT: Okay, please go ahead.

MR. KOROLOGOUS: Thank you, your Honor. Your Honor, going roughly in some of the order that we heard some of the objections, at least for the points that American Express wishes to address, I'd like to start by focusing on apparently one of your favorite cases, Dukes, and identify, again, what the standard is under 23(b)(2) and under Dukes for approval.

Judge Gleeson in the 1720 case described it as Rule 23(b)(2) class is warranted when the party opposing the class has acted or refused to act on grounds that apply generally to the class so that final injunctive relief is appropriate respecting the class as a whole. And as the Supreme Court said in Dukes, the test is whether the challenged conduct, which here is American Express's nondiscrimination provisions in its Honor All Card provisions, whether those provisions can be enjoined or declared unlawful only as to all of the class

members or as to none of them. In other words, Rule 23(b)(2) applies only when a single injunction or declaratory judgment would provide relief to each member of the class.

And the relief here is the rules change, that's agreed to in the settlement. That does not go to the question of who will benefit how much by being able to invoke that rule change or not, who has issues with states or other laws or technology or competitive questions as to whether they can engage in it. So I believe it's clear, your Honor, that the settlement here satisfies the standard for 23(b)(2) and as that applies under Dukes.

There was some comments with respect to the Rules Enabling Act. And on that, your Honor, the Supreme Court has healed that procedural rules such as Rule 23 do not violate the Rules Enabling Act even when they have incidental effects on substantive rights. And this dates right back to 1941 in the Sibbach versus Wilson case where the Supreme Court enunciated the following test: The test must be whether a rule really regulates procedure - the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them.

Then --

THE COURT: Do you think incidental effects includes the potential effect on 20 percent of the merchants in the

United States? Is that incidental to a rules change or is that a substantial potential effect? I mean, isn't it a question of how you define incidental effects?

MR. KOROLOGOUS: I think there is certainly an issue with respect to incidental effects. The question I think here is what are those effects. Here we've got merchants who say they have arbitration clauses. That's what the basis of the Rules Enabling Act argue. That question goes to simply whether they can litigate. Their request is they want to opt out and be able to litigate.

In the arbitration they claim in these objections. But that's no different than any other litigant. Just because you don't have an arbitration clause doesn't mean you do not have a right to litigate. And every opt-out request is a request to be able to litigate on their own. Some do not even bring a claim. Others can bring a claim and seek better relief.

THE COURT: They're saying it's the tail wagging the dog here, that the class members who are bringing this -- the punitive class members who are bringing this litigation do not have a level of interests that the objectors have in terms of consequences of being limited as to how they can proceed if they have a claim. I mean, isn't there something that -- you know, isn't there a balancing that needs to be done in a situation like that? You know, I could as an attorney bring a

class action with a handful of representative members of the class and then I make a deal with the defendant and claim that the class is adequately represented and I can simply negotiate away the rights that the other punitive class members have and the effect of negotiating those rights away has much greater consequence to the objectors than it has to the original class members who brought the litigation? Is that -- I mean, how would we deal with that?

MR. KOROLOGOUS: I think, your Honor, that question, rather than just to the Rules Enabling Act, goes to broader question of application of a 23(b)(2) class in this case at all, including represent --

THE COURT: Right, I jumped to that question.

MR. KOROLOGOUS: I just wanted to make sure that was clear in my mind.

THE COURT: No, I understand what you're saying, but I'm trying to deal with, you know, the heart of what the objectors are saying.

MR. KOROLOGOUS: Certainly, your Honor. I think there are two parts to that question, and I'll address the first and likely leave most of the second to Mr. Friedman; the second being whether he and his clients can appropriately be representative of the other members of the class in its entirety.

Related to that, of course, is the structural and

procedural question of how you resolve that question and whether that is applicable here which goes to the, again, the question as in Dukes of what is the claim that is brought and what is the relief that's being evaluated and should that apply to the class. The claim is on behalf of all merchants that are subject to this rule. Well, all merchants that accept American Express or that might in the future are subject to these rules. They have slight differens but not -- that get negotiated, as we've seen from some of the objectors' statements here and also from the DOJ trial, but those differences don't have differences on the issues that are being resolved here on surcharging. American Express doesn't allow differential surcharging under any agreement, negotiated or not.

We have Honor All Cards rules with everybody on every agreement, whether it's negotiated or not. That's the way our rules are set up, that's what these claims are about, that's what the class is seeking relief on and that's what the relief is that is being granted. So from a structural standpoint as to the relief, I believe that answer more than satisfies Rule 23(b)(2) and Dukes.

Now, perhaps beginning to address the second issue a little bit -- but again I think it's more Mr. Friedman's issue -- some of the arguments I've heard about on, I believe it was the Home Depot's counsel that sounded a lot like you

can't have class actions. You can't have class representatives unless you build an annex on the courthouse to have all 6 million merchants come in. You simply can't get there because there will be differences. There are always going to be differences among the class. The issue is whether the differences matter so that the class representatives cannot adequately represent the interests of all parties that are absent class members or class members that are there. And the standards, we believe, are clearly met with respect to that in this case, your Honor.

Your Honor, there was a, you recall, and it's related to this point, at least with respect to the arbitration clause issue, you recall the colorful chart with many columns and many colors on it. And that, again, goes to the question of whether there are differences among the class that require differences to be dealt with and not dealt with on a classwide basis.

But that kind of a chart could easily be created in a case that has no arbitration clause, if you simply made it about where can you go to get your relief. Well, that depends on the case, is it a federal question or is it diversity. Do you have diversity or not? That depends on what state you live in compared to the defendant. How much your damages are. Can you go to the court here in Brooklyn or do you have to go to federal court in Los Angeles?

All of these things are differences that every litigant faces. Just the mere fact that these litigants have an arbitration clause does not give them some heightened ability to get out of a properly constituted Rule 23(b)(2) class.

THE COURT: Well, it's a question of what's being given up too, not just what are they getting but what are they not getting. And it may not be important to the class representatives as to whether there are restrictions on future litigation and other future remediation under the merchant acceptance agreements. Right?

But it may be that the punitive class members who are not the lead class members of the steering committee who brought the case, that their ability to exercise their rights will be disparaged in ways that the lead class members would not experience simply by virtue of the nature of their -- of the MDP's that they negotiated or other aspects of their agreements with American Express, which give them certain -- currently give them certain rights in litigation or at arbitration that are extremely valuable to them, which they could not exercise. So it's a package, isn't it?

MR. KOROLOGOUS: It is a package. And the question again, as stated in Dukes, is whether it is a uniform package for the class, and here it is. The issue, for instance, with respect to -- let me back up and again make clear so that

there's no question of what the release does in this case. It releases injunctive relieve claims. While it releases steering injunctive relief claims, it's got an express provision that whatever the outcome in the DOJ case, the class members will benefit from them.

So while they've released their claims to bring their own injunction for that, they will live with the DOJ case. So there's no harm to them with respect to that unless somebody could try to articulate that DOJ was not appropriately capable to try the case in order to achieve the ends that it was seeking, which again were with respect to steering and not with respect to surcharging.

An example on that would be the individual merchants cases. We believe, obviously, there are a lot of flaws in the Department of Justice's case. But one of those flaws dows not include what the individual merchant's flaw in addition is, which is their requirement for them to achieve their case that they prove a single brand market, where it's American Express only, effectively arguing that American Express does not compete with Visa, MasterCard or Discover.

So they have even an additional impediment. So I don't think there is anybody that can come forward and say that they are disadvantaged with respect to steering. They are also not disadvantaged with respect to bringing any claims for past conduct, meaning any conduct preceding when American

Express implements the new rules.

All of that conduct under the current rules, to the extent they believe and are able to prove in their individual actions that American Express is both liable and that they've suffered damages that are compensable, they will be able to prove that. Now, we certainly think they will not succeed. But they will have that right. That is not released.

What is released with respect to damages or relating to damages for future conduct where we act consistent with our new rules. There would be no incentive for us or any other merchant settling an injunctive relief class if it had to face damages for following the injunction that gets approved by the court, as it must be. There is simply no incentive to that. Judge Gleeson directly addressed that, that there would be no such incentive. Other courts have addressed that as well.

And the release of those future damages is not inconsistent with Dukes. I believe I heard one objector say damages may not never be released under Dukes. That's not what Dukes says. Dukes expressly leaves open the possibility of the release of damages that are incidental to the injunctive relief, and nothing could be more incidental than to say that a party should suffer a damages claim against it for following the injunction that is permitted by the court to settle the case.

THE COURT: That's why it's extremely important that

in assessing the proposal that the overall scope of the agreement be such that the objectors that all of the class members, including the objectors, will prospectively be treated fairly and be able to protect their rights, because the preclusion of certain types of remedies in this agreement make it clear that the ability of these objectors to vindicate certain rights, potentially, may be foreclosed.

And that's a matter of great concern, particularly when you have a class that's allegedly millions of parties strong. And we've got 20 percent of the merchant group, in terms of sales or operations, you know, sitting in the courtroom saying that they think this is unfair to them. That's a very large percentage of a nationwide class of merchants. I mean, you can add up all the restaurants in America and you're not going to come close, I think, to the group that's objecting in terms of their position in the overall marketplace in the United States.

That's surmise on my part. I love restaurateurs. My family comes from the background of restaurateurs. Maybe your family.

MR. KOROLOGOUS: It does indeed, your Honor.

THE COURT: So I'm not disparaging them individually, I'm just saying collectively what do they account for as opposed to all of these objectors, and isn't it important that I take very careful consideration of the

arguments that they have made that the settlement doesn't adequately protect their rights going forward?

MR. KOROLOGOUS: It is important to look at that, your Honor. And again, there are a couple of ways that the court needs to ensure that that exists here, and it does. First is, again, Rule 23(b)(2), in its application to make sure that there is adequate representation and uniformity of the relief.

The other is to get a look at the scope of the release and whether that is an appropriate scope of releasable claims. And to solve that issue, including because it was such a hot button issue in the 1720 case where there was a lot of dispute about the scope of release and the way that release was written -- and I believe that one is actually a lot longer than the one here -- goes to the question of what the identical factual predicate is. And it is clear under the case law and it is undisputed by everybody in this case, as well as everybody in the 1720 case, that a release may release claims consistent with that doctrine. And that's exactly how the release in this case is phrased. So if it's identical factual predicate, if it's meets that doctrine, it is released. If it does not meet that doctrine, it is not released. We solved that structurally --

THE COURT: What's the status of the 1720 case?

MR. KOROLOGOUS: The appeal briefs have gone in. I

believe the response briefs are due about a month from now and then there will be period of two to four weeks or so after that for reply briefs.

THE COURT: For what, for reply?

MR. KOROLOGOUS: For replies.

THE COURT: And then there will an argument --

MR. KOROLOGOUS: An argument will be scheduled and then --

THE COURT: And we'll find out some day if the circuit agrees with Judge Gleeson?

MR. KOROLOGOUS: I suspect it will be argued and decided sometime in 2015.

THE COURT: So I have no way of knowing at this point whether the circuit court is embracing -- will embrace or not embrace the outcome of 1720 at this time?

MR. KOROLOGOUS: In its totality, I think that's right.

THE COURT: It would have been helpful. But since they haven't received the complete package yet, I can't really say anything about the delay. The delay is that it's the normal course of litigation.

MR. KOROLOGOUS: Correct, your Honor. Let me address a few other points that came up. There were some comments by some merchants that the relief here because it requires parity surcharging will actually set things back

because it will allow American Express to raise its rates. But parity surcharging exists today under American Express's rules. American Express does not have a no surcharging rule, it has a parity surcharging rule. American Express's rates are going down, they're not going up. So we don't think that argument gets them anywhere.

THE COURT: Where are Visa and MasterCard on parity surcharging?

MR. KOROLOGOUS: They now have the 1720 settlement and they've had that since, whenever that was, the beginning of 2013 I think that went into effect.

THE COURT: Have any of their merchants engaged in parity surcharging?

MR. KOROLOGOUS: I believe there is information in the record here that there have been very few engaging in surcharging among those merchants that do not accept American Express, which is where they are able to do that because --

THE COURT: Right.

MR. KOROLOGOUS: -- there's the what Judge Gleeson called the American Express problem. We don't necessarily like that phrase but that's what he called it.

THE COURT: I understand what he's saying.

MR. KOROLOGOUS: But that issue applies to the vast majority of merchants, about six out of nine depending on how you count. But, again, that is the problem that is solved by

this issue on this settlement.

THE COURT: So as to those 4 billion merchants who did not take American Express -- was it 4 million?

MR. KOROLOGOUS: I think about three.

THE COURT: Three. Who do take Visa and MasterCard and Discover, have they had the right to parity surcharge since Judge Gleeson's decision?

MR. KOROLOGOUS: Yes, your Honor, they've had the right to engage in a variety of different surcharging and steering as well as a result of the Department of Justice settlement. You will recall that was an issue where we talked about the statements made by Christine Barney at the time the settlement was announced.

THE COURT: Oh, yes, thanks for reminding me.

MR. KOROLOGOUS: And that -- you know, that was an issue in that case as well, whether merchants had engaged in that steering. But, similarly, those same merchants are among the merchants who would have the ability to take advantage now of the changing rules of 1720 because they are not subject to what Judge Gleeson called the American Express problem.

THE COURT: So do we know how many of them have rushed off to engage in --

MR. KOROLOGOUS: We don't know.

THE COURT: Okay.

MR. KOROLOGOUS: Your Honor, there was something

that Mr. Arnold said in his remarks about Judge Gleeson that reminded me of a case where you asked me about other cases that have involved settlements that have crossed a broad swath of industries and that is another case against Visa which is the Wal-Mart versus Visa case which involved -- it ended up having a class certified under 23(b)(2), as well as 23(b)(3). The case settled.

That was a case about allowing merchants to choose not to accept debit cards and only accept credit cards. Before that case, Visa and MasterCard rules had an Honor All Card rule that required the acceptance of debit cards if merchants also accepted credit cards. So again, that covered some 4 million merchants or so at that time. But, again, it crossed a similar swath of industries because, again, it was merchants that accepted Visa and MasterCard.

THE COURT: Was that a settlement? Was there a settlement?

MR. KOROLOGOUS: It did settle, your Honor.

THE COURT: And were there major objections borne against that settlement?

MR. KOROLOGOUS: I don't recall. I believe some others here were involved in that. I think Mr. Friedman may be able to answer some questions with respect to that.

THE COURT: All right. Thank you.

MR. KOROLOGOUS: Mr. Arnold also took on my

representation to your Honor about their damages claims and their damages theory in this case where I indicated that their damages theory was based on PIN debit rates and using that as a baseline.

And Mr. Arnold spoke some of Mr. Vellturo of -- I can't recall right now whether it's Professor or Dr. Vellturo, who was their expert. It is Dr. Christopher Vellturo. And I don't think there should be any doubt about what the plaintiffs' damages theory is and that it's based on a baseline end of it.

And for that, while there are a variety of cites in both American Express's papers in this settlement approval process as well as in the class papers, I would refer your Honor to July 3, 2013 surrebuttal report of Dr. Christopher Vellturo. And specifically I'll quote from paragraph 213 which is in the section about the overcharge assessment where he is addressing criticisms of my baseline AmEx but-for fee.

He ends that sentence with the following sentence: However, what really matters is that PIN debit rates have always been low and in the but-for world merchants could have credibly used differential pricing of AmEx vis-a-vis debit to shift transaction volumes to this less costly form of payment and drive down AmEx merchant fees."

So in this very case with these very objectors claiming that there's no benefit by being able to shift

customers from credit to debit, their own expert disagrees with their presentations here.

Your Honor, I should also note, I think it was one of the earlier slides that Mr. Arnold put up about surcharging and discounting and whether there's a difference there. Apparently, the Department of Justice thinks there's a difference, since they brought a case that sought to overturn or undo American Express's rules prohibiting differential discounting but they did not seek to overturn American Express's rules with respect to differential surcharging.

Your Honor, you will recall that I mentioned the Giuliani case, it's actually Joel A. versus Giuliani. That is a case that should help the court with respect to the issue of future class members because that is a case that expressly included both current and future class members. I think it involved childcare industry. But it was injunctive relief that could apply both to existing members as well as future class members. I believe that responds to some of the issues raised including by the Buckeye Institute.

One additional point based on, I believe it was the Home Depot presentation. I want to make clear that what Judge Gleeson approved in 1720, the release there did expressly include the release of future damages claims for claims that would follow the rules. And that's, I believe found in paragraph 68 of the Visa/MasterCard settlement agreement in

1720.

May I have a moment, your Honor?

THE COURT: Sure.

MR. KOROLOGOUS: Two more points, your Honor. First, a simple reference point with respect to the government arguments. We've addressed those with one short final section of our brief. And I refer the court to American Express's position with respect to the government there.

The issue is really, in our view, that yes, the Department of Justice has to act on behalf of any agency of the United States, but that's to conduct litigation. And here the way the government would be conducting litigation is to either appear as a party, and they're not a class representative and therefore not a party, or to object. And they've stood here today and objected. The Department of Justice has, we believe, fulfilled the rules consistent with that. We don't see anything in the cases or in the statutes that allow the government to have the ability to claim they're not part of the class inconsistent with the arguments the government has made. But I refer your Honor to the issues there.

THE COURT: Are you aware of any cases where the government has been included as a member of a class in a (b)(2) class situation?

MR. KOROLOGOUS: I'm not sure it was (b)(2), I think

it was a (b)(3) class. There is the Shaw case that we cite in our papers on that.

THE COURT: You would be knocked out in a (b)(3) situation.

MR. KOROLOGOUS: You can be. But the point there, your Honor, is that while they were not dragged into that, they chose to be represented by the class without going through the procedures that they say are required under those statutes. And so we believe that that case supports our position. I do agree with the government.

We've not been able to find a case where the government has been required to be included in a class by that principle. But in that one case we did find that it is somewhat analogous they voluntarily chose to be represented by class counsel.

THE COURT: That's a little different from what we have here.

MR. KOROLOGOUS: It is, your Honor.

Finally, your Honor, with respect to some of the arbitration arguments here and sort of back to the Rules Enabling Act points to some extent. I think it's important to remember again, all of these objections that are seeking opt-outs are essentially saying they want to go on their own. But that is, again, a right that any litigant would have, whether they have an opt-out, whether they have an arbitration

right or not. None of the contracts that they cite, we didn't see a column on the colorful chart, grant an opt-out right.

Indeed, there are cases we cite in our papers that say you cannot contractually enter into an opt-out right. And the arguments that they claim a right to arbitration, those are rights that can be impacted by Rule 23(b)(2). That is the kind of conduct that can occur.

I think it's important to note that these merchants did not bring an arbitration. This case has been around for years. There's been a great deal of notoriety with respect to it, including because of its interplay with 1720, where there was not only a great deal of notoriety but there was the settlement, there was the notice to all class members which is an overlapping and broader class with perhaps a handful of people that accept only American Express and not Visa and MasterCard, where they got notice not just of the existence of this kind of litigation, the Visa/MasterCard case, but that the case there was to involve a 23(b)(2) non-opt-out, in a case where they would be bound by the information -- by the settlement that was included there.

And despite that, these merchants did not bring individual claims, they did not bring the kind of claim that might put them in a different situation, might have different arguments, but we don't have to deal with them if they had brought claims that we were trying to resolve under the

arbitration. But that's not an issue the court needs to fix.

These litigants did not exercise those rights and have not raised them until they come in to court here with respect to objections in a very different context than bringing a claim on their own to exercise those arbitration rights for these rules American Express has had, and your Honor heard, for decades.

THE COURT: But on the other hand, the original cases brought before me were brought by the individual merchant plaintiffs, that's how we got here.

MR. KOROLOGOUS: In this court --

THE COURT: It may have gotten transferred from Judge Gleeson who didn't accept the related -- alleged proposed related status of those cases so that he would handle them.

But Italian Colors is a Southern District case. Right? That case belonged to Judge Daniels. Right?

MR. KOROLOGOUS: Mr. Friedman can more clearly address than I can. His case existed before the case of the individual merchants that's before your Honor.

THE COURT: Not here, though.

MR. KOROLOGOUS: Not in front of your Honor, that's correct.

THE COURT: Judge Daniels sent me that case. Isn't that right?

MR. FRIEDMAN: I don't want to step on Mr. Korologous.

THE COURT: No, I'm not done with him.

MR. FRIEDMAN: Okay. He knows the answers to this anyway.

MR. KOROLOGOUS: There was --

THE COURT: How is that important to me in deciding this?

MR. KOROLOGOUS: Because the -- because the class has had its case longer than anybody else. Nobody, other than the individual merchants that are here, has brought a claim.

THE COURT: Obviously, the individual merchants didn't seize the moment to join in in the case in the Southern District. Right?

MR. KOROLOGOUS: Right, they tried to do it --

THE COURT: They brought an individual case in the Eastern District that they thought was going to go to Judge Gleeson and it ended up with me. And then I got the MDL.

MR. KOROLOGOUS: You got benefits from both courts.

THE COURT: I'm so lucky. But my point is, if they had -- if they thought that they could be adequately represented in the other district, in the other case, they would have been there but they weren't.

MR. KOROLOGOUS: Well, my point in mentioning the individual merchants is to carve them away. There's nobody

that is here arguing an arbitration clause, the individual merchants are not, because they've got their claims in court before your Honor without impact of arbitration clauses some of which they have. But American Express has agreed not to invoke them for their claims.

So everybody that is here before your Honor raising an arbitration clause, every single one of them did not bring their own claim in any court at any time despite the long pending nature of the class.

THE COURT: Let me just ask you this, if you look at this proposed settlement agreement, AmEx gets out of it, or the result is that there is some uniformity in the anti-surcharging rules. In other words, there are limits. Parity surcharging becomes the approach that's used under this agreement. Right?

And so there's a certain uniformity of how surcharging issues are handled, but American Express still retains its MDPs and it still retains the ability to negotiate another critical element of the relationship between the merchant and AmEx and so -- and that's individually negotiated with large merchants. Right?

MR. KOROLOGOUS: Yes.

THE COURT: So what you end up with is in certain respects AmEx basically gets the best of both worlds. It can continue to negotiate the MDPs but the merchants can only

implement a type of surcharging which is, according to some, of little or no real benefit to the merchants.

So the question is: Is this a fair settlement? If you get to do everything that you think is important that I heard seven weeks of testimony about, but the merchants get parity surcharging, which is of dubious or questionable benefit to the merchants? And I'll take that up with Mr. Friedman as well. But you might as well answer since the benefit is to American Express allegedly.

MR. KOROLOGOUS: Your Honor, first of all, with respect to some aspects of our MDPs, the ability of American Express to go forward with respect to those will be decided by your Honor, in appellate courts with respect to the DOJ case insofar as steering.

THE COURT: Let's say they haven't met their burden for the sake of this discussion.

MR. KOROLOGOUS: Okay, I'll agree with that.

THE COURT: Well, no, for the sake of this discussion.

MR. KOROLOGOUS: I understand. I understand.

THE COURT: I don't even have your papers yet.

MR. KOROLOGOUS: Tomorrow, your Honor. We're working on them over here as we speak.

THE COURT: Where is Mr. Orsini?

UNKNOWN SPEAKER: Working on them, your Honor.

THE COURT: Yeah, he's not here, which worries me.

MR. KOROLOGOUS: It worries all of us.

THE COURT: You can tell him.

But you understand my point, that, let's say the government is not successful and all we're left with here is the class settlement agreement and some litigation over damages from the individual merchants plaintiffs that goes to damages which have already allegedly been experienced.

MR. KOROLOGOUS: I believe the right way to look at it, your Honor, at least from American Express's perspective, is that we have with this settlement some limitations on what we can require under our agreement with merchants. Regardless of whether it's negotiated or not, we will have limitations on what we can do. We will have to allow merchants to differentially surcharge as between the group of credit and charge cards on the one hand where there needs to be parity surcharge, but they may need to surcharge that group differently than they do debit. And that is a change from what American Express does today. And so that ratchets back the MDPs by that amount.

You're correct that American Express could still negotiate but it cannot take that benefit away from the class because we've got a settlement agreement, at least not without blowing our release. We can't take that benefit away from the class.

And so, yes, we will continue as we have to neglect agreements, as we must, unlike Visa and MasterCard that just impose rules. But we will have limitations on what we can do with that. Just like if we were to lose, arguendo, the DOJ case, we would have further limitations on what we could negotiate with respect to steering.

THE COURT: If American Express implements and produces a new product, a debit product, how would that potentially impact the future rights of merchants except the American Express, under this agreement, if it at all?

MR. KOROLOGOUS: Under the agreement, it depends on the kind of debit card that is introduced. If it is what we define as a traditional debit card that draws on a deposit account, that is a card that merchants would not need to accept. So that would be a change in our Honor All Cards rule, that merchants could chose, if they don't like that card, if they felt -- for instance, I believe this was one of the reasons that the class asked for this in the agreement. If they felt that was a channel by which American Express was trying to circumvent the issues with respect to surcharging that we settle in here with respect to credit and charge cards compared to debits by packing in a traditional debit card that has awards, merchants could choose not to accept that. They could say, look, that's a high priced debit, I don't want to deal with it because you're running rewards through that and

choose not to, despite what has been our Honor All Cards rule before that any product we issue has to be accepted by American Express if they chose to accept any cards.

THE COURT: Is that realistic for the consumer, that if you take your -- assuming you have more for that product, you take your AmEx debit card into a merchant who accepts the American Express card and the merchant then says, no, we don't honor that American Express card, are you willing to do that?

MR. KOROLOGOUS: Well, I think, your Honor, that it is at least sufficiently possible for merchants to do that, including because they would have the right perhaps with just a sign that says we accept American Express but we don't accept this American Express debit card, that what it does is imposes discipline on American Express not to engage in that conduct. And so I believe this was described by the class in its brief as a safety valve stop to prevent American Express from having that means of circumventing the other rules. So --

THE COURT: It also flies in the face of the repeatedly stated comments by witnesses in the government trial that it's important that the American Express card be welcomed at merchants who agree to accept the card.

MR. KOROLOGOUS: Right. And I don't want to speak on behalf of the business, but I'm sure based on that testimony and my knowledge of the business, American Express

would not want to create the kind of confusion that that would create by welcome acceptance by having some cards that American Express has out there that are not accepted.

THE COURT: Right, I understand.

MR. KOROLOGOUS: So we would not try to force it.

THE COURT: So I think it's really -- it's a provision which is there but really doesn't have any immediate possibility of being implemented.

MR. KOROLOGOUS: Right. We don't think it's going to be an issue but I do believe it provides some benefit the way Mr. Friedman negotiated it to prevent American Express from having an end run.

THE COURT: Okay.

MR. KOROLOGOUS: Thank you, your Honor.

THE COURT: Thank you very much.

Mr. Friedman, you get the last word.

MR. FRIEDMAN: Thank you, your Honor.

I think a lot of the discussion comes down to adequacy of representation. And the question of the tail wagging the dog is an adequacy representation question. And, you know, we have a different view on the tail and the dog to start with. Okay?

THE COURT: Well, who are you -- who are representative clients for the class?

MR. FRIEDMAN: The representative clients --

THE COURT: Who are the companies that initiated all of this?

MR. FRIEDMAN: This was initiated -- in addition to the Marcus Corporation that's been discussed here today, a couple of -- there's two restaurants, the Italian Colors restaurant.

THE COURT: We know about them.

MR. FRIEDMAN: Right. Animal Land, a pet relocation company. There's a liquor store, a gas station. There's a handful of small merchants. Those are mom-and-pop operations with the exception of Marcus which is a New York Stock Exchange traded company. It's a mid to large size hotel operator. It operates Hilton, Marriotts and others.

THE COURT: In other words, they have franchises to operate hotels?

MR. FRIEDMAN: Right. They also have their own brand named hotels. They have good resorts in Wisconsin and Las Vegas under their own brand.

THE COURT: My question is not to disparage any of their interests in bringing this litigation. But in terms of, you know, whether they adequately represent, you know, 8 million merchants, including the merchants who are objecting, that's a question.

MR. FRIEDMAN: So they brought this case and started this, brought the case in the first instance in 2006, two and

a half years before the individual merchant plaintiffs did, and it was in front of Judge Pauley. You remember that?

THE COURT: Oh, I remember that. Both Judge Pauley and Judge Daniels --

MR. FRIEDMAN: He wanted to be on the Brooklyn Bridge.

THE COURT: -- have been very enthusiastic about my handling of this case.

MR. FRIEDMAN: Yes, right. Right. And so we brought this to get relief for all merchants because we thought that this is an area where it's not just American Express's business imperative that this be uniform but there's an -- that there are values to the universality. We walked through a bunch of that in our paper. We thought it's important to have the broad relief.

So the question that arises, the legal question, to put this into a legal framework is, is there adequacy of representation. Because we're not using these words colloquially. Right? We're using them in the sense of what does the Second Circuit mean when it talks about adequacy of representation, what is it under the law.

And the Second Circuit has a -- and I'm going to quote from the Joel A. versus Giuliani case that Mr -- actually, this quote is to the Wal-Mart case at the Second Circuit which is quoting Joel A. And it's, the Second Circuit

has considered whether a subset of a class can ever lack adequate consideration, adequate representation when the lead plaintiffs of that class possessed the claims of that subset.

So it all comes down -- I know you've seen this in the briefing. It all comes down to whether we possess the same claims. And the answer is we possess the same claims. Every case that was adverted to by the objectors as being a case where there was -- where adequacy of representation was found lacking, every single one is a case where the representative plaintiffs didn't possess the same claims as the absent class members, as the objecting class members.

There is a case, I think it was Home Depot, I might be wrong. It was talking about Stephenson versus Dow Chemical, one of the Agent Orange cases, and you have there a class of people who had already gotten sick from their exposure to the product. And they reached a settlement not only on behalf of themselves but also on behalf of those people for whom the illness hadn't manifested. And they took all the money for the people who were already sick and set aside none for the others.

That's the same fact pattern as in Ortiz versus Fibreboard, a Supreme Court case, and Super Spuds, the Second Circuit. This isn't that. This isn't that. So to find that adequacy of representation is lacking, you have to find that we don't possess the same claims.

You know, Home Depot, if it wants to go forward, has the ability to go forward and press a claim seeking differential surcharging under whatever dispute resolution provisions it has in its agreement, arbitration, court, it doesn't matter. That's a lesson I absorbed from Justice Scalia, that these are all equal in all of these different forums, it doesn't matter where. So they can go ahead and press their claim for differential discharge. Well, so can Marcus. So can Italian Colors. So can Animal Land. And it's not just that they have the formal legal technical ability to do it. We shouldn't have doubted that they will do it and they would do it.

Animal Land, as I said in my opening remarks, started what became MDL 1720 when it filed a case for injunctive relief only again Visa in 2005. Italian Colors. Nobody should doubt the resolve of these merchants. Nobody should doubt how serious they are about controlling their acceptance costs. They've been out in front of this from day one. They're out in front of the cases that are attacking the state statutes. Those aren't money makers.

THE COURT: I understand. But it may not be as important to them to give up a right in the future as it is to some of the other members.

MR. FRIEDMAN: I would respectfully disagree. It might not be as remunerative.

THE COURT: As remunerative?

MR. FRIEDMAN: It might not be as -- it's not worth as much. I'm going to agree with you absolutely, unconditionally, it is not worth as much by orders of magnitude to Italian Colors Restaurant to give up the rights as it is to Home Depot. I agree with that.

THE COURT: Okay.

MR. FRIEDMAN: But legally where are we? The question is, is there adequacy of representation? And there is. What these merchants have decided, each of them has the same ability to go forward and seek to get their differential surcharge rights, is it's not worth it. It's better to take the bird in the hand than the flock in the bush.

THE COURT: But once I approve this class settlement agreement --

MR. FRIEDMAN: Yes.

THE COURT: -- they lose the ability to negotiate other aspects in the future of their relationship with American Express because some of their rights have been folded into the agreement. Isn't that right?

MR. FRIEDMAN: They lose their right to seek differential surcharging. And I think -- I'm just trying -- I think that's what your Honor is saying. It's -- they lose their right to go into the court, into arbitration, or elsewhere and say, I want the right to do unfettered

differential surcharging, that's correct. They're settling for a second best, that's correct.

Six million merchants will get this second best and there's a tremendous overstatement that's been repeated by objector after objector here about the extent to which differential surcharging is superior to imparity surcharging. The nomenclature itself is misleading. But the slides that I put up earlier, there is a great deal of competition inside the credit card industry that's going to be fomented by this relief that we're calling parity surcharging.

THE COURT: But they also lose other rights, they lose the right to challenge the Honor All Cards provision, don't they --

MR. FRIEDMAN: Well, some --

THE COURT: -- and to challenge the MDPs, the existence of the MDPs?

MR. FRIEDMAN: Right.

THE COURT: Which is the heart of the government's case and the government might not win their case.

MR. FRIEDMAN: Not one person -- okay, can I take those in pieces --

THE COURT: Sure.

MR. FRIEDMAN: -- because I think they're very distinct. Not one objector has come in here and said they have any interest remotely in challenging the Honor All Cards

rule. We had an Honor All Cards theory. We prosecuted it in Marcus and we -- and there's just no question in the minds of anybody who ever went forward with that theory that this package of relief here solves that problem.

THE COURT: Let's talk about the MDPs.

MR. FRIEDMAN: Okay.

THE COURT: I have witness after witness in the bench trial over the summer --

MR. FRIEDMAN: Right. Right.

THE COURT: -- who indicated their problems with the MDPs.

MR. FRIEDMAN: That's right. So this is a really unique situation. I know of no other situation quite like it. But the situation is this: We have this trial, the United States against American Express. They joined our party in 2010. We were thrilled that they did.

Now, in this settlement context, if they weren't there could we have settled this case this way and just walked away from the MDPs? Would we have? I don't think so. But they do exist. And it's an understatement of the world to say that this is a very able legal team. They are bringing -- they're bringing those claims. If they win those claims, it's moot. If they lose those claims, why on earth should we think that we would have done better?

THE COURT: Because you have market power as a

class, don't you? I mean, what you're doing -- I'm just playing devil's advocate here.

MR. FRIEDMAN: Okay.

THE COURT: What you're doing is you're relinquishing to the government the negotiation or the resolution of the MDP issue.

MR. FRIEDMAN: Yes.

THE COURT: And you're making a settlement with American Express that doesn't include a resolution of the MDP issue because you're relying on the government to be successful.

THE PLAINTIFF: Correct. And if the government -- with the full understanding that if the government isn't successful, we weren't going to be. That was our judgment.

THE COURT: If the government -- but if the government --

MR. FRIEDMAN: On MDP.

THE COURT: If the government isn't successful --

MR. FRIEDMAN: Right.

THE COURT: -- would your agreement be fair to the members of the class?

MR. FRIEDMAN: If the government isn't successful, if the government isn't successful, then we cut the deal of the century. Okay, if the government isn't successful, the relief for the merchant class is just parity surcharging but

no one was going to get anything.

If the government is unsuccessful in this case, they have all of the advantages, their market power theory, the ability -- you know, as opposed to drugstores and supermarkets for whom American Express represents a very small portion of their spend, the government can come in and they bring in Discover and they're talking about the market, if anybody is able to prevail on market power it's them.

Second, their case is an easier case.

THE COURT: I didn't understand the point about the drugstores. What are you saying about the drugstores?

MR. FRIEDMAN: My point is that there's -- I think -- I don't want to take anything from Mr. Arnold and Mr. Slater's case, great lawyers and good friends.

THE COURT: Just tell me what your point is.

THE PLAINTIFF: My point is that -- well, my point is simply that they have certain challenges. They have clients for whom American Express represents a very small percentage of their spending. And a jury -- I don't know what inferences the jury is going to make.

THE COURT: Were you here when the chairman of Walgreens came in and told us his story?

MR. FRIEDMAN: Yes.

THE COURT: Pretty compelling story about the power of American Express in connection with insistence, wouldn't

you say?

MR. FRIEDMAN: I would. So maybe that suggests that all plaintiff groups should be in a position of winning here. But recall the point that I was making was that our judgment was that if DOJ is to not prevail on those claims, we have no reason to believe that we would have prevailed on those claims. And if that's true, we're not walking away from anything.

THE COURT: Well, you made a big point about differentiated as opposed to parity surcharging. Right? But isn't it true that in Australia -- I know I'm opening Pandora's box with Australia. But Australia there's a lot of differentiated surcharging. That point was made by someone --

MR. FRIEDMAN: Mr. Slater made that point.

THE COURT: Yes.

MR. FRIEDMAN: We put in compelling evidence that actually suggests that the vast majority of surcharging in Australia is on a parity basis. Mr. Slater came in and they put in evidence from the same source, credible also, that suggests if you do the math that much less than what we were saying is parity.

Nobody is asking your Honor to be the arbiter of that. I don't think that that's necessary. What we do know -- what we do know is absolutely undisputed is that huge swaths of commerce in Australia entire industries, hotels, car

rental, air, are doing parity surcharging. And I just don't understand for the life of me how we can sweep this evidence under the rug.

Mr. Arnold came in here and said Australian evidence is terribly important. Mr. Slater is relying on Australian evidence. Their experts are relying on Australian evidence. We're all looking at Australia evidence.

I think part of the problem, if I may stick my neck out a little bit for better or for worse, is in Professor Hemphill's report he placed a fair amount of reliance on the work of the expert for 7-Eleven, and that was Professor Hausman. He's a very well respected economist. And Professor Hausman made some flat-out errors, and we pointed those out respectfully, in response to Professor Hemphill's report.

Once you give due consideration to the undisputed evidence you'll see that there is massive, massive parity surcharging in Australia. And if even -- even -- even any percent of that represents what we're going to see here in the United States -- and I think you would see more parity surcharging in the United States than Australia.

One quick slide, the Allen chart. You know, in Australia there's a substantial premium in American Express's rate over the rate of Visa and MasterCard. So that suggests that people would want to surcharge differentially and not on a parity basis.

The picture in the United States is very, very different. So --

THE COURT: I'm sorry, which? This is new.

MR. FRIEDMAN: Well, it's only new in its electronic form.

THE COURT: No, it's new today.

MR. FRIEDMAN: It's new today, that's right. It's in our slide. It was in our brief. I wasn't sure if that was a joke.

THE COURT: Okay, that's fine. Well --

MR. FRIEDMAN: The -- we get even -- I don't know if your monitor is as fuzzy as this one.

THE COURT: They're all the same.

MR. FRIEDMAN: That's the point, is that you've got -- is that this is the surcharging that matters in the United States, it's parity. And to the extent that you want to introduce competition, if you're willing to surcharge, then you can do exactly what I was talking about in my remarks here this morning. Do this parity surcharging and cut deals with Discover, cut deals with American Express, cut deals with MasterCard, then you get to the same place.

THE COURT: Okay.

MR. FRIEDMAN: So another issue, much is being made of just the fact itself that all these large merchants are objecting. And I'm concerned that this fact is sort of --

become sort of a factor unto itself. And so I wanted to say a couple of things about that.

One, Mr. Arnold stated that in 1720 all the objectors that you have here, other than his group, they were not objectors in 1720, but the 1720 objectors were objecting in furtherance of a regulatory legislative agenda that they wanted to see a capping of interchange rates, and they thought that that was undermined by the 1720 settlement.

In objecting to the 1720 settlement, including now on appeal of the Second Circuit, their top level argument is that the surcharging relief we got in 1720 does us no good because there's this American Express problem. So they need the AmEx problem to stay exactly where it is, as a problem so that they can defeat the 1720 settlement.

None of these objectors in here said anything to you about having any genuine interest in wanting to, oh, the release harm -- nobody came in and said, the release harms me because I want to sue AmEx for X, the release harms me because it's going to force me to give up my right to sue AmEx for Y. It's just for some unstated thing in the future.

And I think that's telling. I think that's telling. I think that you kind of put those facts together and you get a picture that it's not that there's some genuine ground swell of support against this deal, that this deal actually prejudices their interest. It doesn't. It prejudices their

ability to defeat the 1720 settlement which has been this political cause celeb.

You asked earlier about if we had domestic indications of interest in parity surcharging. And, you know, because I tend to rely on all of the overwhelming evidence that we have from Australia that you asked me about domestically. So it's not going to rise to that level. Obviously, we don't have the kind of data that we have from Australia but just sort of anecdotally, the gas stations that you engaged in colloquy with I think it was Mr. Shinder, you know, gas stations that have -- whether you want call to it a surcharge or whatever, you know, two prices, the dual pricing, very common, we all know that. It's all parity. Have you ever seen it vary by brand? You have?

THE COURT: Some say it's 10 cents, some say it's 15.

MR. FRIEDMAN: No, by brand.

THE COURT: By brand?

MR. FRIEDMAN: Yeah. So they'll say credit card, I forget the prices today, credit card is 4.50, you know, cash, whatever it is.

THE COURT: You got to find a new gas station.

MR. FRIEDMAN: Okay. So whatever it is, credit card price.

THE COURT: What did you mean by that? I didn't

understand what you meant.

MR. FRIEDMAN: So it's a credit card price and cash price.

THE COURT: Right.

MR. FRIEDMAN: But within credit price, have you ever see Visa price, MasterCard price, Discover price, American Express price? I'll bet not. Parity surcharging.

THE COURT: I see.

MR. FRIEDMAN: You see my point?

THE COURT: I see your point.

MR. FRIEDMAN: That's what surcharging merchants are going to do. That's what they're going to do. This idea that we need to be differential, it's not true, it doesn't happen. That's not the way it works. You know how complicated it would be to do it differently by brand? Your head would spinning at the pump.

THE COURT: I would surmise as a consumer it might depend on the ticket price of a particular item. If they're buying a subzero refrigerator for $10,000, you can bet that a savvy wealthy consumer might want to do differential -- understand that there might be differential surcharging because the differential surcharge could mean the difference of hundreds and hundreds of dollars.

MR. FRIEDMAN: I totally get that.

THE COURT: I'm just saying.

MR. FRIEDMAN: I share --

THE COURT: Over gasoline it's a different story.

MR. FRIEDMAN: So ex ante I would share that's surmise. As a matter of evidence, high ticket is exactly where we see parity surcharging in Australia. And I told you it's literally undisputed fact that all of the hotels are doing parity surcharging, all the airlines, not all, virtually all. It's in our papers. That's literally undisputed.

THE COURT: Okay.

MR. FRIEDMAN: In the United States, livery, you know the example that I give earlier --

THE COURT: Livery?

MR. FRIEDMAN: Livery, you know, car services.

THE COURT: Yeah.

MR. FRIEDMAN: So they're very often surcharging in the US, parity. They don't do it differently by brand. I mentioned the anecdotal example the other day. You come into Newark airport, it's 5.50 extra. Not by brand.

But government official payments testified in this case. They do, I call it surcharging, they call it convenience fees. Whatever. But it's not different prices for different brands.

THE COURT: Well, it was. They have two different product lines. One is a parity surcharge, because they got AmEx, according to the testimony, to lower its discount rate.

And the other one they identified the online that if you use your American Express card it costs you a different price --

THE PLAINTIFF: Right.

THE COURT: -- as a surcharger.

MR. FRIEDMAN: Okay. But --

THE COURT: I'm just saying --

MR. FRIEDMAN: Okay, I got you.

THE COURT: -- this is what happened.

MR. FRIEDMAN: DMVs, parking violation bureaus, college tuition, all the people who are doing convenience fees around the country, it's parity, parity, parity. So in terms of domestic. And the illegal surcharges. As you know, we've been leading those -- you may know. We've been leading those cases challenging the state, anti-surcharging statutes, including the one for Judge Rakoff here in New York.

And the Florida AG, for example, has a file on people who have surcharged. They send cease and desist letters. We got that from Florida request. We included that evidence in our moving papers. Those are parity surcharges. Those are the surcharges that people are doing. They're illegal, but it tells you it's parity surcharging.

Mr. Slater and Mr. Arnold couldn't be more powerful in coming in here and telling you surcharging matters, people are going to surcharge, this tool matters. I agree with them it matters.

So the question becomes, are we talking about parity surcharging or differential surcharging? All the evidence -- it's not all the evidence. Most of the evidence is on my side of this one. Mr. Slater, I give him credit on some of the Australian evidence that he mentioned before, I promise not to drag your Honor into.

Mr. Korologous --

THE COURT: They're saying that the marketplace should decide and you're saying you and American Express should decide.

MR. FRIEDMAN: Well --

THE COURT: I mean, that's --

MR. FRIEDMAN: Neither of us have the option to say that the marketplace should decide. If this is the only option for 6 million merchants, that's the problem, that's the problem. It would be easier if that weren't the case.

THE COURT: I'm only playing devil's advocate here.

MR. FRIEDMAN: I know.

THE COURT: I haven't reached any conclusions but I'm trying to bring out all of these considerations so that I have a better understanding of where everybody is.

MR. FRIEDMAN: Right. If there was any suggestion about how the 6 million merchants could get relief with whichever flavor, parity or differential, other than the settlement, we would have heard of it. It ain't there. So

it's this or nothing for 6 million merchants and those guys want a little bit more for themselves. I don't begrudge them that, but that's the story.

THE COURT: Do you think 6 million merchants even know what's going on?

MR. CANTER: No, but do you think that -- I don't know how many merchants there are in Australia, but do you think they knew at the beginning? They didn't know either. And then it happened. It happened. It started from nothing. We know that they -- oh, surcharging is never going to get hold -- take hold, and now it's undisputed that 40 percent of Australian merchants are surcharging. By the way, that's one of the facts that Professor Hemphill, with all respect, got a little bit wrong based on Professor Hausman's misreading of the evidence, which well --

THE COURT: You've pointed that out.

MR. FRIEDMAN: Pardon?

THE COURT: You've pointed that out.

MR. FRIEDMAN: Yeah, but I just wanted to tell you that that's the place where it goes.

THE COURT: What other points would you like to make?

MR. FRIEDMAN: Okay, Mr. Korologous stole my thunder on cohesiveness.

THE COURT: That's fine.

MR. FRIEDMAN: I want to talk about arbitration really quickly, because counsel for the NRF was here and said that it's very important that the NRF have its right to pursue its ability to go into arbitration, that it values this right, wants the ability to go pursue its right in arbitration. I want to read to you what the NRF and its lawyers wrote to the Supreme Court as an amicus brief. Just real quick, it's two lines.

THE COURT: From which case?

MR. FRIEDMAN: My case.

THE COURT: Nice.

MR. FRIEDMAN: Sorry.

THE COURT: Which time?

MR. FRIEDMAN: Oh, which time at the Supreme Court? The merits time, the bad one. The last time.

THE COURT: The last time?

MR. FRIEDMAN: Yeah. Yeah.

THE COURT: Go ahead.

MR. FRIEDMAN: Meaningful relief requires an injunction on behalf of large groups of merchants. How do you -- I don't know how you square that with what NRF was in here saying today.

Meaningful relief requires an injunction on behalf of large groups of merchants. And then they go on and they say, the American Express agreement, quote, explicitly

precludes a merchant from seeking in arbitration any relief on behalf of any other merchant. And so they say it totally precludes the possibility of meaningful relief. So what they're arguing for here is, please let us go pursue meaningless relief.

I want to just touch on something Mr. Korologous did and then I think I'm done, and that is the argument that from all these dispute resolution clauses that you saw, the big chart, according to, it was Mr. Canter, many of these merchants have a right, a contractual right to be free of class actions.

We bargained for the ability to get out of a class action, they say. That's fine. The Shady Grove case that Mr. Korologous mentioned, here is what that case was really about. That case said there was a New York State statute that gave the defendant a right to be free of class actions in a troubled damage case. Don't you remember it came out -- it was in CPLR, that you have the right to be free of class actions.

And the argument, it went up to the Supreme Court, was the defendant saying hey, we have a right, state law right to be free of class actions. And the application of Rule 23 to this in the federal court, that violates the Rules Enabling Act because that's a substantive right. Scalia said, no, it's not. Justice Scalia said, no, it's not. No, it's not.

That's just Rule 23 doing its procedural thing being Rule 23.

And the fact that it might affect substantive interests as in the Sibbach case that Mr. Korologous talked about, that's of no moment, that's true in every case. And if they're right on the Rules Enabling Act, then Rule 23(b)(2) is a walking Rules Enabling Act violation, because in every mandatory class settlement people's substantive rights were foreclosed. You can't -- I couldn't think of one in which that wouldn't be the case.

So that's all I've got.

THE COURT: Thank you.

MR. FRIEDMAN: Thank you.

THE COURT: Now, there are have been a number of exhibits that have been offered here today and I need to give them numbers so that the record is clear.

MR. FRIEDMAN: Oh, I'm sorry, your Honor, I don't know, did we hand up our slides. We neglected to hand up our slides, so may I approach?

THE COURT: Sure.

All right, I'm going to number them. Court's Exhibit No. 1 is the class plaintiffs' presentation which I was going to ask for hard copy on but I now have a hard copy.

Court's Exhibit No. 2 is the Target Objectors, the NRF's presentation provided by Mr. Canter.

Court's Exhibit No. 3 is the individual merchant

plaintiffs' presentation provided by Mr. Arnold.

Court's Exhibit No. 4 is chart entitled quote, Acceptance of AmEx at the top 100 retailers by 2011 US sales which was presented by counsel for Southwest Airlines, Mr. Slater.

Court's Exhibit No. 5 was a document entitled Merchant Surcharging Australia, end quote, and dated March 2007, which was also presented by Mr. Slater.

Court's Exhibit No. 6 is excerpts from the testimony of Mr. Quagliata from the bench trial in the government's case against American Express, which similarly was presented by Mr. Slater.

I think that covers it.

(Court Exhibits 1 through 6 received in evidence.)

THE COURT: Anything else that I've missed? I don't think so. Okay.

With regard to confidential sealed material, to the extent that any exhibit provided to the Court includes information that must remain confidential under the protective order in this case, the party who proffered the document should provide the court with a copy suitable for public dissemination by this Friday, the confidential versions will be filed under seal for the purposes of completing the record of today's hearing.

Okay, is there anything further from the proponents?

MR. FRIEDMAN: No, your Honor.

MR. KOROLOGOUS: No, your Honor.

THE COURT: Anything further from the objectors that hasn't been said three or six times?

MR. FRIEDMAN: No, your Honor.

THE COURT: Okay, thank you everyone.

(Adjourned.)

I N D E X

SPEAKERS: **PAGE**

COURT'S EXHIBITS MARKED IN EVIDENCE